

POLICY BRIEF

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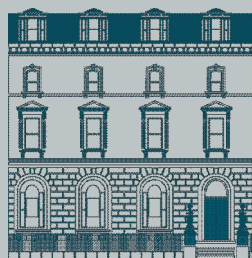
A G-20 CAUCUS FOR EAST ASIA

WHAT IS THE PROBLEM?

In September 2009 the Pittsburgh Summit designated the G-20 as the world's premier forum for international cooperation. The G-20's arrival at the apex of the international economic architecture gives East Asia a much greater presence at the top table of the world economy: six regional economies, including Australia, are members of the G-20, in contrast to the G7, which only had room for Japan. This increase in representation creates important new opportunities for the region. But making use of these opportunities requires significant increases in policy-making resources. Unfortunately, in many Asian economies, such resources are in short supply relative to the wide variety of pressing problems the region currently faces.

WHAT SHOULD BE DONE?

A caucus of the six East Asian members of the G-20 would offer economies of scale by providing the opportunity to pool resources for research and the preparation of policy papers on matters of common interest. This could help the region identify and promote an agenda at the G-20 which would not only support regional interests, but would also assist the group itself in establishing its relevance and keeping leaders engaged. The establishment of an East Asian caucus could also provide a positive contribution to the development of the regional economic architecture.



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- produce distinctive research and fresh policy options for Australia’s international policy and to contribute to the wider international debate.
- promote discussion of Australia’s role in the world by providing an accessible and high-quality forum for discussion of Australian international relations through debates, seminars, lectures, dialogues and conferences.

Lowy Institute Policy Briefs are designed to address a particular, current policy issue and to suggest solutions. They are deliberately prescriptive, specifically addressing two questions: What is the problem? What should be done?

The views expressed in this paper are entirely the authors’ own and not those of the Lowy Institute for International Policy.

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The rise of the G20

The original G-20 – the Group of 20 finance ministers and central bank governors – was borne out of crisis: the Asian financial crisis of 1997-98. [See the Annexure for more detail on the G-20]. Similarly, the elevation of the G-20 to a leaders meeting and, ultimately, a place at the apex of the international economic architecture, was a product of another crisis: this time, the Global Financial Crisis of 2007-2009(?).

G-20 leaders first met in Washington in November 2008 and this inaugural gathering was quickly followed by the London Summit of April 2009 and the Pittsburgh Summit in September the same year. At Pittsburgh, the assembled leaders agreed to lock in the G-20 as the paramount international economic consultative body. According to the final communiqué:

‘Today, we designated the G-20 as the premier forum for our international economic cooperation. We have asked our representatives to report back at the next meeting with recommendations on how to maximize the effectiveness of our cooperation. We agreed to have a G-20 Summit in Canada in June 2010, and in Korea in November 2010. We expect to meet annually thereafter, and will meet in France in 2011.’¹

This recognition of the G-20 as the peak international economic consultative body is an important step forward for the world economy. The G-20 offers the world the opportunity of a more effective, a more representative, and hence a more legitimate, body than the G7.

The big and likely tricky issue of country membership has now come as close to being resolved as it is ever likely to be, and, moreover, has been done so in a way that gives a potentially significant place for those countries which until now have been on the periphery of international financial architecture.²

While this is all good news, however, it is only a start. The mind-focusing challenges of the Global Financial Crisis gave the three initial leaders’ meetings special impetus: a crisis creates opportunities for reform. Now that impetus has to be maintained. To put substance in the promise, the G-20 needs to identify and actively pursue an agenda which will establish its usefulness and keep the leaders interested.

An opportunity for East Asia, and a challenge

The success of the G-20 is not just a win for the global economy. It’s also a win for East Asia. While the G7 found room at the world’s top table for just one regional economy – Japan – the G-20 makes space for a further five: China, India, Indonesia, South Korea and Australia. Asia has long felt – quite rightly – that its views have been under-represented. The G-20 is an important step towards changing that.

The growth in East Asian representation from 1/7 to 6/20 is, of course, a reflection of the region’s growing heft in the world economy: taken together, the six East Asian members of the G-20 account for about 28% of world GDP measured on a purchasing parity basis.³ It’s also a recognition that the region is central to

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most of the key policy issues facing the world economy, whether this is macroeconomic policy coordination and the issue of global imbalances, governance and reform of the international financial institutions (IFIs), or international trade and protectionism. It's now impossible to imagine a satisfactory agreement on any of these issues that did not involve a substantial contribution from the region.

The G-20 offers East Asia a major opportunity to help shape the international economic environment. But seizing that opportunity also poses the region with a significant challenge. A common – and in some cases self-interested – criticism from some of the established powers that is applied to Asian aspirations for a greater voice in world affairs is that while East Asia has made up its mind that it should have a bigger say, it has been unable to explain what it would do with it once it gets it.⁴

Shaping, or reshaping, the international environment requires identifying, producing, refining and ultimately selling policy ideas. That in turn requires both the will and the ability to deliver a significant increase in the policy-making resources that will be applied to this task. Given that in many regional economies, such policy-making resources are in short supply relative to the wide variety of challenges those same economies already confront, this means that the region faces a potentially important resource constraint when it comes to maximising the opportunity now offered by the G-20. Indeed, this point may well up end up applying more generally, since as the diplomatic stage gets more and more crowded with institutions and meetings, servicing the full agenda will start to strain even

the biggest and most well-resourced Foreign and Finance Ministries.

Furthermore, the existing regional architecture is not up to the job of presenting a regional voice at the global level – not least because none of it was designed to fulfil this role.⁵

The case for a caucus

One way to loosen this resource constraint would be by promoting the formation of an East Asian caucus group.⁶ The function of such a group would be first, to identify G-20-type issues which lend themselves to the formulation of a regional position, second, to refine and distil a consensus argument, and third, present this to the rest of the G-20 as something which has the backing of the caucus members.

In addition, given that the function and operation of the G-20 itself is, to a large extent, still up for grabs, the creation of an East Asian caucus would enhance the region's ability to help shape the future workings of the new grouping.

What is the right membership?

The obvious membership for such a caucus would be the six existing East Asian members of the G-20, including Australia.

First, by including all the regional members in the G-20, this maximises the influence of the caucus within the larger grouping.

Second, all six of these countries are also members of the 16-country East Asia Summit

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(EAS).⁷ This provides a natural link back into a wider regional forum.

It is possible, however, that not all six East Asian members of the G-20 would want to be involved, at least initially. If this proved to be the case, a smaller grouping, not linked to the EAS, could be a fallback or interim objective.

What about other membership arrangements?

While we favour an East Asian caucus that includes all six East Asian members of the G-20, there are clearly other possible configurations.

One option would be to focus on just the four countries – China, Indonesia, Japan and South Korea – that are also members of the ASEAN Plus Three (APT) grouping, which is currently at the core of the existing East Asian regional architecture.⁸ In our view, the larger grouping offers several advantages over a narrower, APT-based club:

First, by including India the caucus gains the weight that comes with the membership of one of the world’s major emerging economies, and moreover one which is already a significant player in the international economic architecture.

Second, by including Australia, the caucus benefits from the membership of a country that has already played a significant role in the creation and subsequent elevation of the G-20, and which has a strong and proven record in providing a substantive contribution to international policy debates.

Alternatively, instead of ‘going narrow’, caucus membership could ‘go wide’ and seek to encompass the G-20 membership of APEC, so adding the United States, Canada, Mexico and Russia to the group, and bringing total membership to ten. This would change the nature of the caucus from an East Asian grouping to an Asia and Pacific grouping, however, and would arguably represent too large and diverse a collection of economies for effective caucusing.

Finally, with the United States now a potential future member of the EAS, a caucus including the world’s largest economy would be a third possibility.

What topics should the caucus consider?

Two factors need to be taken into consideration regarding possible topics for the caucus to consider.

First, the starting-point has to be the G-20 agenda, as set out in the Washington Action Plan, the Global Plan for Action and Reform, and the G-20 Framework for Strong, Sustainable, and Balanced Growth.⁹ That said, however, there are also likely to be longer-term opportunities to modify or add to this already agreed agenda.

Second, the existing agenda need to be juxtaposed against the interests of the caucus members and the feasibility of achieving a consensus which can also make a real contribution to the G-20 discussion: there is little to be gained from arriving at a unified viewpoint that is so wishy-washy or ill-defined that it will have no operational impact in the

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subsequent G-20 discussion. We recognise that the diversity of views within the region makes this a challenging requirement, but note this also means that this is precisely where the caucus could add value.

Keeping these two points in mind, a look at the issues currently under discussion at the G-20 suggests the following possible topics:

Macroeconomic policy coordination

The immediate issue facing all G-20 members here is the withdrawal of fiscal and monetary stimulus, and the removal of bank guarantees – all of which would benefit from a degree of international coordination.¹⁰ There is also a fairly sustained push, particularly from Washington, for a G-20 focus on global imbalances.

The interests of the caucus countries here may be to widen the current debate on external imbalances so that it is less focused on the bilateral imbalance between the United States and China, and more focused on the kind of policies that will be required to maintain and expand globalisation, especially in capital flows.¹¹

Other topics that may present useful coordination opportunities would cover capital flows (a major cause of international volatility and a subject of repeated concern to several of the East Asian members of the G-20 in particular) and exchange rates, where the old prescription of ‘corner solutions’ – either a simple free float or some form of permanent peg – has come into greater question. The major issue here for the region is how to maintain a degree of stability in longer-term relative competitiveness (helpful for the steady

price signals it would give to tradable sectors) in the face of large swings in the major currencies.

International coordination of prudential regulation

At Pittsburgh, the G-20 leaders pledged to work on ‘Strengthening the international financial regulatory system’. Much of the *current* international debate on this topic does not impinge strongly on many of the Asian countries, because it is largely about how to organise the prudential supervision of complex international banks: who will supervise their cross-border operations and coordinate cross-border aspects of crises?

Historically, this focus has meant that many of the Basel II principles for banks (developed by the G10 countries) were more appropriate for the complex international banks. The simpler structures that are prevalent in many regional countries do not need the heavy weight of this complex regulatory superstructure, which distorted the prudential effort and directed it into areas which were not of major concern to many banks in Asia. Efforts made some years ago to develop a more appropriate set of internationally-endorsed standards were disparagingly called ‘Basel Lite’, which discouraged countries from going down that route.¹²

Now, with the downside of complexity clearly demonstrated in the United States, there might be a new opportunity to develop a more appropriate set of principles which would be internationally endorsed in a way that made their adoption more attractive for more of the East Asian countries.

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Representation and governance at the IFIs

The endorsement by G-20 leaders of the need for change in IFI governance represents an opportunity to belatedly update the anachronistic post-WWII balance of power in the IFIs. So far, many regional countries have been reluctant to make a major issue out of this, but have instead seen the IFIs as a relatively minor part of their international diplomacy. A concerted effort via the G-20 might hasten this reform and give the East Asian countries more reason to play a fuller role here.

The use of IFI funding

As well as leading to the elevation of the G-20, the GFC has given the IMF a new lease of life, with leaders committed to a significant increase in the financial resources available to the Fund.¹³ This development raises at least two important issues for East Asia.

First, how to coordinate the regional crisis-response architecture (primarily the Chiang Mai Initiative) with the IMF's more global approach.

Second, how to achieve a better response to the sort of situation which arose in 2008, when countries which had not made any particular policy mistakes, but rather were victims of almost pure financial contagion, were nevertheless reluctant to take on an IMF 'program', in part because that would have put them in the same camp as those countries which had overextended their external position, and in part because of the unacceptable domestic political fallout.

Resisting protectionism

At all three Summits held to date, leaders have made rhetorical commitments to refrain from protectionism. At the Washington Summit, for example, Leaders said:

*'We underscore the critical importance of rejecting protectionism and not turning inward in times of financial uncertainty. In this regard, within the next 12 months, we will refrain from raising new barriers to investment or to trade in goods and services, imposing new export restrictions, or implementing World Trade Organization (WTO) inconsistent measures to stimulate exports. Further, we shall strive to reach agreement this year on modalities that leads to a successful conclusion to the WTO's Doha Development Agenda with an ambitious and balanced outcome'*¹⁴

Yet according to one independent report:

*'Conservatively estimated, 121 beggar-thy-neighbor measures have been implemented by G20 governments since last November. Every three days a G20 government has broken their no-protectionist pledge.'*¹⁵

Given that the region has been a significant winner from open global markets for goods and services, the caucus could usefully consider methods other than the usual rote invocation of the importance of the Doha Round to help resist any further increases in trade barriers. For example, the caucus could consider the proposal that economies adopt a domestic transparency institution to highlight the costs of protectionism, along the lines already implemented by some regional economies.¹⁶

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Dealing with climate change

G-20 Leaders have already made reference to climate change and the upcoming Copenhagen meeting, and climate change policies are a potentially fruitful area of regional cooperation. There are several important issues here, including how to get emerging markets involved in specific carbon-related plans; how to implement international trade in pollution rights that might be a big source of ‘win-win’ for the world, as there are many cheap opportunities for pollution reduction in the emerging countries; and how to avoid the damage to the international trading system that could be caused by ‘green protectionism’. This area is also an example of an issue where the caucus might feed into places other than the G-20 – that is, Copenhagen or its successors.

What’s in a G-20 caucus for the rest of East Asia?

While a successful caucus for East Asia in the G-20 could become a powerful group within the G-20 and as such provide significant benefits for the existing regional members of the group, it could also have some positive impact on other economies in the region.

First, if the link to the EAS is maintained as suggested above, the caucus could enhance the status and operational usefulness of the EAS, and so help strengthen the current regional economic architecture.

Second, this same link to the EAS would provide a means by which other regional economies could filter their own views into the G-20 leaders’ meetings.

Third, this would produce a greater regional voice on global issues – a payoff that is currently missing from the existing regional structures.

One challenge that this proposal will have to overcome is that it will arouse a degree of suspicion on the part of non-members, some of whom might see it as an attempt to usurp or sideline existing regional structures, by, for example, encouraging Indonesia to shift its focus away from ASEAN. In large part, of course, the answer to such fears lies firmly within the control of the other regional bodies themselves: that is, to the extent that they currently offer members a significant positive benefit, they should be safe from any diversion of interest. Moreover, the idea of a caucus as proposed here is as an informal supplement to existing regional structures, not a formal replacement. Finally, a consultation process through the linkage back to the EAS could also help assuage such concerns.

What’s in it for the rest of the G-20?

As well as benefits for East Asian members and non-members of the G-20, a caucus along the lines proposed here would offer some potential gains to other G-20 members as well.

First, and as noted earlier, one criticism sometimes voiced by non-Asian economies is that while East Asia is keen to have a greater voice in managing the world economy, the region tends to be reluctant to take on a more active leadership role or to come up with policy proposals. A successful East Asia caucus could help bridge this alleged gap between aspiration and delivery.

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Second, by contributing towards a more dynamic Asian voice within the G-20, the caucus will help keep the G-20 relevant and other leaders engaged.

Third, if the linkages between East Asia's caucus group and the rest of the region could be made to work effectively, perhaps through the EAS as proposed here, this would be a useful step towards a more 'bottom-up' international architecture, where regional groupings sort out issues in a more inclusive setting and then bring this consensus to the overarching G-20 framework. Done effectively, this indirect representation for a wider group of countries would take some of the pressure off the G-20 to continually enlarge, a trend which would threaten its effectiveness.

What's in it for Australia?

Australia has already successfully demonstrated its credentials as a member of the G-20 by its work in promoting the group itself, by identifying issues for the agenda and by contributing to the substantive discussion of these. This active role could now be expanded still further by promoting the formation of an East Asian caucus group to link the East Asian regional economic discussions more firmly and effectively with the G-20 agenda.

The caucus would provide an opportunity for Australian policy-makers to sit down with the region's leading economies to discuss matters of global and regional significance.

Finally, to the extent that the caucus provided a further boost to the EAS, this would also

benefit Australia's aspirations for the regional economic architecture.

Conclusion

The elevation of the G-20 to the apex of the international economic architecture means a greater presence for East Asia at the world economy's top table. Securing a substantially larger role in the international architecture has both pluses and minuses for the regional members. The pluses include the opportunity to help shape the global economic order. But to make use of the opportunities, significant increases in policy-making resources would need to be applied to this area. In many of the countries of East Asia, such policy-making resources are in short supply relative to the wide variety of pressing problems these countries face. A caucus could offer economies of scale: the opportunity to pool resources for research and the preparation of policy briefing papers.

If this caucus proved useful, there would also be potential to expand its application to cover the other key international financial forums which now have expanded Asian membership – for example, the Basel Committee of Bank Supervisors and the Financial Stability Board.

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NOTES

¹ *Leaders' Statement: The Pittsburgh Summit*. Available for download at:

<http://www.pittsburghsummit.gov/mediacenter/129639.htm>.

² The membership question is probably as resolved as it can be: in practice, there is likely to be continued lobbying from those countries that feel they have missed out.

³ Based on estimates for 2009 from the IMF's October 2009 World Economic Outlook database. Measured using US dollars the share falls to a bit over 22%.

⁴ For one version of this kind of argument, see Kishore Mahbubani, A gaping silence. *Newsweek*, 1 December 2004. An alternative interpretation is that in the past while the region may have had its own views on international issues, it has been unable to articulate these effectively in what was a Western dominated system. See for example Robert Wade, Japan, the World Bank, and the art of paradigm maintenance: The East Asian Miracle in political perspective. *New Left Review* May-June 1996.

⁵ The inadequacy of the existing regional architecture for this task has been emphasised by Peter Drysdale, among others. See for example *East Asia's moment of truth*, East Asia Forum, 1 February 2009, available at:

<http://www.eastasiaforum.org/2009/02/01/east-asias-moment-of-truth/>.

⁶ Hadi Soesastro has made the case for leaders of the Asian G-20 members to 'direct their finance ministers to have regular 'strategy meetings' to strengthen East Asia's engagement in formulating G20 policies and actions towards the recovery of the global economy and in shaping global economic governance.' See *East Asia, the G20 and global economic governance*, East Asia Forum, 8 March 2009, available at:

<http://www.eastasiaforum.org/2009/03/08/east-asia-the-g20-and-global-economic-governance/>.

⁷ Along with the six G-20 members, the other 10 countries in the EAS are the nine other* members of ASEAN (Brunei, Cambodia, Laos, Malaysia, Myanmar, Philippines, Singapore, Thailand, Vietnam) as well as New Zealand. *Existing G-20 member Indonesia is also a member of ASEAN.

⁸ The APT comprises the ten member economies of ASEAN plus China, Japan and South Korea.

⁹ The text of the Washington Action Plan is available at:

<http://www.pittsburghsummit.gov/resources/125137.htm>; the London Summit's Global Plan for Action and Reform at:

<http://www.pittsburghsummit.gov/resources/125131.htm> and the G-20 Framework for Strong, Sustainable, and Balanced Growth is part of the final communiqué from the Pittsburgh Summit, at: <http://www.pittsburghsummit.gov/mediacenter/129639.htm>.

¹⁰ While there is little debate on the degree of international spillover from monetary policies, the case of fiscal policy is more controversial, with the bulk of the evidence suggesting that cross-border spillovers from fiscal policy are weak. For an argument as to why this result may not apply to current circumstances, see Paul De Grauwe, To coordinate or not to coordinate, *VoxEU*, 24 September 2009. Available at:

<http://www.voxeu.org/index.php?q=node/4020>.

¹¹ For more on global imbalances and a possible role for the G-20, see Stephen Grenville, *External imbalances and the G20*, Policy Brief, Lowy Institute, Sydney, 14 September 2009. Available at: <http://www.lowyinstitute.org/Publication.asp?pid=1122>.

¹² See for example, Alistair Milne, "Basel Lite": recommendations for the European implementation of the new Basel Accord, Centre for the Study of

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Financial Innovation, 2003; also *Basel Lite* from *The Economist*, 1 July 2004.

¹³ Since the onset of the crisis, the IMF has committed over US\$160 billion in new loans and credit lines, compared to little more than US \$1 billion in 2007. Back from the dead: The International Monetary Fund, *The Economist*, 17 September 2009.

¹⁴ <http://www.pittsburghsummit.gov/resources/125137.htm>.

¹⁵ *Broken promises: a G20 Summit report* by Global Trade Alert. Available at:

<http://www.globaltradealert.org/gta-analysis/broken-promises-g20-summit-report-global-trade-alert?top-ad>.

¹⁶ See Bill Carmichael, Saul Eslake and Mark Thirlwell, *Message to the G20: Defeating protectionism begins at home*. Policy Brief, Lowy Institute, Sydney, September 2009. Available at: <http://www.lowyinstitute.org/Publication.asp?pid=1115>.

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ANNEXURE

The G-20: What is it and where did it come from?

The Group of Twenty (G-20) Finance Ministers and Central Bank Governors was established in 1999 to bring together systemically important industrialised and developing economies to discuss key issues in the global economy. It was a response both to the financial crises of the late 1990s and to a growing recognition that major emerging markets countries were not adequately represented by the existing global economic architecture.

The G-20 is made up of the finance ministers and central bank governors of 19 countries:

Argentina
Australia
Brazil
Canada
China
France
Germany
India
Indonesia
Italy
Japan
Mexico
Russia
Saudi Arabia
South Africa
South Korea
Turkey
United Kingdom
United States of America

The European Union, represented by the rotating Council presidency and the European Central Bank, is the 20th member. In addition, the Managing Director of the IMF, the President of the World Bank, plus the chairs of the International Monetary and Financial Committee and Development Committee of the IMF and World Bank, also participate in G-20 meetings on an ex-officio basis.

In November 2008, as a response to the global economic crisis, the G-20 held its first leaders' meeting, the Washington Summit on Financial Markets and the Global Economy. This has been followed by meetings in London in April 2009 (the 'London Summit') and most recently in Pittsburgh in September

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2009 (the ‘Pittsburgh Summit’). At Pittsburgh leaders designated the G-20 as the ‘premier forum for . . . international cooperation’ and scheduled future meetings for Canada in June 2010, Korea in November 2010 and France in 2011.

While the G-20 leaders’ meetings have continued to include the same core group of 19 countries plus the EU, invitations have also been extended to a range of countries, regional bodies and international institutions not included in the original grouping. These have included Spain, the Netherlands, the Chair and Secretary-General of ASEAN, the President of the European Commission, the Chair of New Partnership for Africa’s Development (NEPAD), the Secretary-General of the United Nations, the Director-General of the WTO, and the Chairman of the Financial Stability Forum (reconstituted at the London Summit as the Financial Stability Board).

Sources:

What is the G-20: http://www.g20.org/about_what_is_g20.aspx; Who will attend the London Summit?: <http://www.londonsummit.gov.uk/en/summit-aims/faqs/general-questions/who-will-attend>;

About the G-20: <http://www.pittsburghsummit.gov/about/g20/index.htm>.

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