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Delivering Prosperity in the Indo-Pacific

An Agenda for Australia and the United States

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For the purposes of this report, the definition of the “Indo–Pacific” is the same as the Australian Government’s 2017 Foreign Policy White Paper, as the region ranging from the eastern Indian Ocean to the Pacific Ocean connected by Southeast Asia, including India, North Asia and the United States.

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Introduction and Overview

The ongoing shift in global economic weight to the Indo-Pacific region presents tremendous opportunities for Australia and the United States, along with risks and significant challenges.

If the United States and Australia are not proactive in agenda setting, rulemaking and shaping markets and outcomes together, American and Australian businesses and consumers could be cut out of growing markets. And growth potential in Asia will be lower without proactive Australian and U.S. engagement and policy leadership. Both countries share a deep strategic interest in keeping Asian markets open, contestable, and rules-based.

The opportunities are large, and the risks are real. Maximizing the benefits will require careful, strategic decisions and leadership.

The opportunity is to capture the benefits from Asia's rise. Asia already [contributes 60 per cent](#) of global economic growth and is currently home to half of the world's [middle class](#). The region is predicted to account for two-thirds of the global middle class by 2030, adding an extra 2.1 billion people to the global middle class. There are significant opportunities for Australian and American businesses, entrepreneurs and consumers, and these opportunities will continue to grow.

A major challenge to realizing these opportunities is to reinforce and extend the practices, rules and institutions supporting open and well-functioning markets, particularly as emerging market economies become even more important in global growth. Both countries already work together on common interests in the Asia-Pacific Economic Cooperation (APEC) forum, the Group of 20 (G20) and other forums but much more can be achieved with deeper and more purposeful cooperation.

Seizing these economic opportunities is a necessary part of a portfolio approach to meet the security challenges of more assertive military and cyber activities by some countries and as the regional and world order becomes more multipolar. Economic engagement generates prosperity and influence for Australia and the United States, and it creates a much deeper and more resilient set of interests in the peaceful resolution of conflict.

Australia and the United States should work together, and with other countries in the region, to keep markets open, entrench market disciplines and enforce rules to sustain and grow living standards. China, India, Indonesia and other emerging markets need to continue to open their own markets to continue development. Southeast Asian countries will only remain some of the fastest growing in the world with favorable external conditions to continue their reform and opening-up. Japan, South Korea and other high-income countries in Asia will continue to be important partners in innovation and sources of technology and investment.

To help realize and capture the benefits from the growth prospects in Asia, Australia and the United States can jointly lead work with Asian countries, either as bilateral partners or within key forums like APEC and G20, in five priority areas: infrastructure, investment facilitation, energy, digital economy, and financial systems. This report contains policy recommendations that will help address some of the structural causes of economic frictions and provide a credible pathway for all countries to prosper in a peaceful and stable Indo-Pacific region. Summary recommendations include:

Infrastructure

- Develop a compelling and positive vision for connectivity in the Indo-Pacific
- Build consensus around principles for public and private infrastructure investment
- Create a regional mechanism to empower countries to advocate for quality infrastructure and strengthen dispute resolution when problems emerge
- Improve and expand infrastructure financing options for the region
- Untie infrastructure aid in exchange for improved infrastructure governance
- Continue to monitor regional infrastructure projects with strategic implications

Investment Facilitation

- Make investment retention a priority in the region
- Use regional organizations to raise investment standards, set best practices, promote competition and regulatory reform, and employ new financing mechanisms like asset recycling
- Partner with and expand sub-regional private sector initiatives
- Actively shape the investment facilitation agenda in the World Trade Organization (WTO)
- Promote full implementation of the WTO Trade Facilitation Agreement

Energy

- Make well-functioning domestic energy systems a priority in the region
- Accelerate a stable energy transition in the region
- Lift public confidence in the sustainable extraction of gas
- Deepen regional gas markets to underpin energy security in the Indo-Pacific
- Accelerate reform of the focus and governance of the International Energy Agency

Digital Economy

- Strengthen principles and best practices for regulation of digital commerce in the region
- Invest more in setting standards for critical emerging technologies
- Deepen engagement at the WTO to reach agreement on digital commerce rules and make consumer interests the focus of reform
- Strengthen digital infrastructure to connect individuals to the global trading system
- Help small businesses take advantage of digital trade and compete in global markets
- Share policies and experience on worker retraining and improving labor mobility
- Deepen cooperation in defending against cyber threats

Financial Systems

- Make strengthening and deepening financial systems, capital markets, and open and fair trade in financial services across the Indo-Pacific a priority
- Get ahead of the next crisis and reduce spillovers on the United States, Australia and others in the region
- Better integrate Asia into the global financial safety net and limit fragmentation of the global financial architecture.

The recommended actions in these five key priority areas will help lock in reforms, realize growth potential in ASEAN, China, and India and maximize opportunities for Australia and the United States. It will create opportunities for other South Asian countries to join in the rapid growth and development path of East Asia.

Some recommendations will find willing partners across Asia, including in China, India, Indonesia and Japan. Other recommendations will find resistance from some countries. The key for Australia and the United States is to continue to extend the practices and rules supporting open markets. The recommendations in this report follow principles that will further achieve open and well-functioning markets and create new sources of economic growth across the whole region. These recommendations will empower reformers in Asia and help realize more opportunities. Extending and entrenching the practices and rules supporting open markets will help to reduce and mitigate the risks and challenges.

Canberra and Washington can shape and entrench the practices and rules supporting open markets so that private businesses, entrepreneurs and consumers can capture the benefits in the Indo-Pacific. In doing so, both countries can help create open, competitive markets that maximize the income, opportunities and security of the Australian and American people. It is an opportunity too great to miss.

Areas for Cooperation

I. Infrastructure

Recommended Actions

- **Develop a compelling, positive vision for connectivity in the Indo-Pacific, starting with bilateral dialogue with key partners** Together with Japan, India, Singapore and Indonesia, the United States and Australia should create a positive strategy for infrastructure development in the Indo-Pacific. This would guide engagement in the region and signal the commitment of the United States and Australia to promoting sustainable growth and working with others, including China. This vision should deepen relevant sections of the “free and open Indo-Pacific” strategy and clearly explain what quality infrastructure means and how sustainable financing benefits recipient countries.
- **Build consensus around principles for public and private infrastructure investment in APEC and G20.** The United States and Australia should work with partner countries through multilateral development banks and other organizations such as the Asia Pacific Economic Cooperation (APEC) forum and G20 to reach consensus on key issues such as open and transparent procurement processes, sound environmental and social safeguards, and debt sustainability. This should build on the [Ise-Shima Principles for Promoting Quality Infrastructure](#) agreed by the G7 in 2016 and provides a basis to form regional principles, including China and India. If a consensus on baseline best practices is reached, the United States and Australia should encourage other countries in the region to integrate these standards into their visions for regional connectivity. If an agreement proves elusive, pathfinder initiatives can help garner support at a plurilateral level.
- **Create a regional mechanism to empower countries to advocate for quality infrastructure, by bringing together ministers in APEC responsible for infrastructure.** The United States and Australia should create a body that countries can call on for capacity building and assistance with project development and evaluation. The entity, which could draw on staff from bilateral aid agencies and multilateral development banks, would be charged with generating, together with recipient countries, a pipeline of “bankable” projects. It should include an informal dispute mediation and formal dispute settlement component that builds on established international arbitration courts in London, New York, and Singapore. Washington and Canberra could request a one-off APEC Infrastructure Ministers meeting to deliver this action, drawing on government and private sector expertise (with the United States represented by the Secretary of Commerce or Transportation). This would also facilitate information sharing around problem solving in urban and national infrastructure planning.
- **Improve and expand infrastructure financing options for the region.** Adequate resources are necessary to promote a sustainable development vision and offer an alternative to lower-quality financing. Working bilaterally, with partner countries such as Japan, and in multilateral development banks, the United States and Australia should deepen targeted, strategic financing mechanisms to unlock private sector

investment, including export-import banks and development finance corporations. This should include trials that draw on the funds of institutional investors, like pension funds, which constitutes the largest untapped resources for future infrastructure investment, including through asset recycling. The United States and Australia should coordinate with likeminded countries to substantially increase the pool of infrastructure financing by maximizing private investment.

- **Untie infrastructure aid in exchange for improved infrastructure governance.** Along with other donor countries, the United States and Australia should seek an agreement within the region that infrastructure aid should be untied from domestic companies in return for recipient countries making commitments to open procurement, market-based regulation, anti-bribery and corruption standards. Donor countries can help monitor project governance to ensure these commitments are practical and enforceable. The United States and Australia should seek similar commitments from other big donors in the region, including China and Japan. The United States and Australia should work with others in the region and in the private sector to develop a public-private agreement of principles for infrastructure financing, where donors, recipients and the private sector – both contractors and financiers – agree to certain principles and projects gain a label of approval if they meet these principles.
- **Continue to monitor regional infrastructure projects with strategic implications, starting with a workshop with ASEAN.** The United States and Australia should work with developing economies in the region on identifying and safeguarding critical infrastructure, including from cyberattack. They should deepen data sharing and analysis of key infrastructure projects. Not only will this provide greater transparency around projects, but it will help uphold sovereignty and independence of third countries.

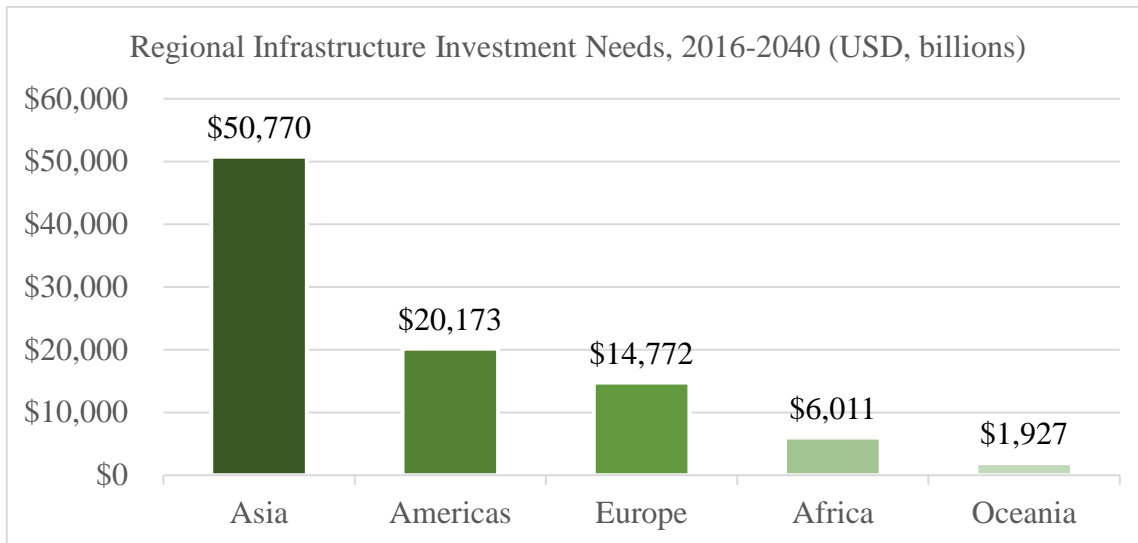
The Challenge

The need for infrastructure investment is immense. An additional [\\$94 trillion](#) of global infrastructure investment is needed by 2040 to keep pace with massive demographic, environmental, and economic changes. According to the [World Bank](#), Asia accounts for more than half of this need – over \$50 trillion.

Despite wide agreement about the importance of increasing investment, there is no consensus about how to get there. The world's leading and emerging powers, including China, Japan, and India, have [competing visions](#) for tomorrow's infrastructure and different models for building it. One of the most well-known is China's [Belt and Road Initiative](#) (BRI), a \$1 trillion plan to strengthen infrastructure and connectivity in Eurasia.¹ In response to BRI, in 2015 Japanese Prime Minister Shinzo Abe unveiled the [Partnership for Quality Infrastructure](#) (PQI), a \$200 billion collaborative effort with the Asian Development Bank to finance infrastructure projects. In July 2018, the United States, Australia, and Japan [announced](#) they would cooperate to encourage regional infrastructure in the Indo-Pacific region through public-private partnerships. Multilateral organizations also have ambitious

¹ There are different estimates of the scale of the BRI, depending on what is counted under the BRI umbrella and the timescale. For more details, see in text link.

infrastructure financing programs, including the Group of 20's [Global Infrastructure Hub](#) and the Association for Southeast Asian Nations' (ASEAN) [Master Plan on Connectivity 2025](#).



Source: [World Bank](#)

These approaches are uncoordinated and often work to achieve different priorities and criteria.² Countries vary in their approaches to procurement, debt sustainability, and social impact standards. Loans approved through the BRI often use tied aid to require Chinese contractors to complete projects and have less emphasis on controlling risks up front. Beijing recently set up [special courts](#) in China that have unclear operating principles to handle BRI-related disputes. Japan uses a different approach, persuading recipient countries to pay more up-front for projects that advance sustainability goals and cost less over their lifetime. The United States focuses on facilitating private sector infrastructure financing, rather than official development assistance. Yet Chinese aid is appealing because of greater resources and risk tolerance to fund projects that may not be economically viable.

The challenge is to ensure that these approaches are done in a consistent way, with strong political buy-in, to deliver the key objective of securing the best economic and social outcomes in each country. There are competing sources of infrastructure financing with insufficient capacity or governance in many recipient countries to assess sustainable, quality, and high-return projects. Regional cooperation and transparency are lacking among funding countries, recipient countries, and between them. It is timely to explore how to use the multilateral development banks to adopt transparent procurement practices on social and environmental safeguards and how to use the IMF and Paris Club for debt resolution around failed infrastructure.

Recognizing the need for higher common standards, support for “quality infrastructure” has been growing. This is expected to be a large part of President Donald Trump’s [agenda](#) going forward and has consistently received attention in the G20 and G7. “We agree on the importance of improving the quality of public finances,” leaders [wrote](#) at the G7 summit in Italy in 2017, “including by prioritizing high-quality investment, such as infrastructure.”

² One recent development is the announcement during Prime Minister Abe’s visit to Beijing in October 2018 of 52 joint Chinese-Japanese infrastructure investment projects in third countries. For more details on the implications, see <http://www.eastasiaforum.org/2018/10/28/japan-joins-to-shape-chinas-belt-and-road/>

Argentina also listed “[infrastructure for development](#)” as one of the three key issues of their G20 presidency in 2018. The focus on quality infrastructure will only grow as Japan, a leader in this area, assumed the G20 presidency in 2019.

In May 2016, the G7 released the [Ise-Shima Principles for Promoting Quality Infrastructure](#):

- **Principle 1:** Ensuring effective governance, reliable operation, and economic efficiency in view of life-cycle cost, as well as safety and resilience against natural disaster, terrorism, and cyber-attacks risks.
- **Principle 2:** Ensuring job creation, capacity building, and transfer of expertise and know-how for local communities.
- **Principle 3:** Addressing social and environmental impacts.
- **Principle 4:** Ensuring alignment with economic and development strategies, including aspects of climate change and environment at the national and regional levels.
- **Principle 5:** Enhancing effective resource mobilization including through Public-Private Partnerships.

These principles are difficult to disagree with, but Japan, the United States, Australia, and other supporters of “quality” infrastructure face two central challenges. First, they need to broaden support for these goals. Particularly among developing economies, there is a risk that “quality” is conflated with luxury, viewed as nice-to-have rather than essential. Layering on too many requirements will make quality impractical or even unachievable. Nor should “quality” become a euphemism in the west for “not Chinese,” which is counter-productive to efforts in China to raise standards and ensure its considerable investments are sustainable. Looking ahead, Japan’s G20 host year is an important opportunity to build a larger coalition for “quality” infrastructure. That coalition has to involve emerging market countries in standards setting.

The second challenge is operationalizing these principles. For all the talk about “quality,” experts differ about what these aspirations should mean in practice. The term “sustainable,” for example, is commonly used to cover everything from environmental issues to financing and maintenance. This is a balancing act, of course. The more detail that is provided, the more difficult it is to sustain a broader consensus. But without greater specificity, principles can be dismissed as platitudes or espoused but not implemented.

Whether and how the world meets its infrastructure needs carries wide-ranging consequences and strategic implications. Many infrastructure projects are dual- or multi-use with security implications, especially those involving information and communications technology (ICT). The standards adopted for these projects will govern what companies can build foundational network, potentially creating security risks. Unsustainable lending can threaten national sovereignty when a country cannot service its loans. In certain situations, debt can be used to gain control of strategic assets, like Sri Lanka’s [Hambantota port](#), or extract diplomatic concessions. This has been the case elsewhere, including the [Kaohsiung Container Terminal](#) in Taiwan, [Haifa and Ashdod Ports](#) in Israel, and “[oil-for-loan](#)” deals in Venezuela.

U.S. and Australian Engagement

The United States and Australia have championed sustainable infrastructure development in the Indo-Pacific. Washington and Canberra recently agreed to a [trilateral partnership](#) with Tokyo to invest in projects in the region that “drive economic growth, create opportunities, and foster a free, open, inclusive, and prosperous Indo-Pacific.” The three countries have signed Memorandum of Understanding codifying these principles and have deepened channels of cooperation. At their first official meeting, the group explored investment collaboration in Indonesia, Thailand, and Singapore. Future discussions will focus on promoting sustainable infrastructure financing in the region.

As part of the Trump administration’s “free and open Indo-Pacific” strategy, the U.S. is promoting sustainable investment in the region and infrastructure that is “physically secure, financially viable, and socially responsible.” To realize this vision, in July 2018 the Trump administration [announced](#) \$113.5 billion in funding for new strategic initiatives in the Indo-Pacific. This included \$30 million to launch an Infrastructure Transaction and Assistance Network (ITAN) and an Indo-Pacific Transaction Advisory Fund. These pilot initiatives will establish a new interagency body to facilitate financing and technical assistance and will help partners secure advisory services, respectively.

This will build on existing U.S. engagement in the region, which has generally focused on leveraging private sector investment. The U.S. Overseas Private Investment Corporation (OPIC) has [\\$3.9 billion](#) invested in the Indo-Pacific alongside the private sector. The [BUILD Act](#), which was signed into law on October 5, will double U.S. government development finance capability to \$60 billion and enable the new International Development Finance Corporation (IDFC) to take equity positions in projects. In partnerships with allies, Washington has emphasized the importance of private finance, rather than official government aid. U.S. strength comes from Wall Street and the standards and training that U.S. companies provide, not from Washington.

Traditionally, Australia has [relied](#) on development banks to finance infrastructure projects, and Australia is the [second-largest donor](#) to the Asian Development Bank. Yet Canberra has taken a more active role recently. In June 2018 Australia [announced](#) it would fund most of the Solomon Islands-PNG-Australia undersea high-speed internet cable contract, including a domestic marine cable network in Solomon Islands. Australia has also been on the [cutting edge](#) of using innovative financing models for infrastructure – 197 domestic infrastructure assets have been privatized since 1980 – and has shared this knowledge with the region. For example, the [Australia Indonesia Economic Cooperation Partnership](#) provides technical and capacity-building assistance to improve public sector performance and private sector infrastructure investment opportunities in Indonesia, including state-owned enterprise reform. Australia has committed to create an [Australian Infrastructure Financing Facility for the Pacific \(AIFFP\)](#).

The Opportunity

The United States and Australia agree on the importance of sustainable development and the need for principles that ensure quality infrastructure investment. By working together with regional partners, Washington and Canberra can strengthen investment standards and dispute resolution mechanisms that underpin economic and social infrastructure in the Indo-Pacific.

The United States and Australia should offer their own compelling, positive vision for Indo-Pacific connectivity and work constructively with major donors like China and Japan to ensure that the region's huge infrastructure needs are met in a way which supports enduring economic and social development. A positive U.S.-Australian vision would form the basis for engagement with the region on infrastructure and clearly articulate the value of quality infrastructure. More importantly, it would signal a renewed commitment from Washington and Canberra to regional economic growth, instead of opposing projects without offering an alternative. Australia and the United States should follow the lead of [Japan](#) and work bilaterally with China on joint projects in the region that meet high standards and are of significance to the countries involved.

Working through multilateral development banks and other international organizations like APEC and the G20, Washington and Canberra can build consensus with other countries in the region on infrastructure standards. Best practices for public and private infrastructure investment should include the need for independent cost-benefit analysis of projects; open, transparent, and competitive bidding to deliver projects; and strong governance to ensure investment delivers the intended economic and social outcomes. By developing a shared set of objectives and principles that integrate private, domestic, and international approaches to infrastructure investment, governments and societies can be more confident that infrastructure in their country will be effective in delivering the intended economic and social outcomes.

As part of this vision, Washington and Canberra should empower emerging economies to be their own best advocates. A regional mechanism that countries can call on for capacity building and assistance with project development and evaluation is an important first step in strengthening decision making. With its focus on information sharing, collaboration and informality, APEC is the organization best placed to deliver this priority. The United States and Australia can request an APEC Infrastructure Ministers meeting to deliver this action, drawing on government and private sector expertise to support recipient countries negotiating on terms of infrastructure investment. Regional dispute mediation and/or resolution mechanisms to enforce these principles are more complex but provide a way to ensure that the economic and social outcomes intended from infrastructure investment are delivered. This vision should include a dispute mediation component helps countries file cases at international arbitration courts in London, New York, and Singapore.

To realize this vision, the United States and Australia should expand infrastructure financing options in the region. The global infrastructure gap is too big for any single player to fill, so private sector investment will be necessary. Both countries should deepen existing initiatives, including export-import banks and development finance corporations, and cooperate with partners in the region, including the World Bank, Asian Development Bank, European Bank for Reconstruction and Development, [IFC Asset Management Company](#) and the Asian Infrastructure Investment Bank, to maximize the participation of private sector capital, including by drawing on the resources of private and public institutional investors through asset recycling. Implementing best practices and transparent governance principles in the region could reduce investor risk, leading to more projects and unleashing trillions of dollars of long-term U.S. assets looking for reliable returns. To spur reform, the United States should, like Australia, along with other donor countries, agree to untie infrastructure aid from domestic companies in return for commitments from recipient countries to open procurement,

pro-market, and anti-corruption regulations. The United States and Australia should work with other major donors in the region, like China and Japan, to pursue similar reform.

The private sector should be part of an effective system of governance of infrastructure investment. Governments in the region should work with the private sector to develop a public-private agreement of principles for infrastructure financing, where donors, recipients and the private sector – both contractors and financiers – agree to certain principles and projects gain a label of approval if they meet these principles.

Finally, the United States and Australia should work with recipient countries in the region on identifying and safeguarding critical infrastructure, especially from cyberattack. The two countries should continue to monitor infrastructure projects with strategic implications through information sharing and collaborating intelligence operations. Better monitoring won't only protect US and Australian interests, but also the sovereignty and independence of third countries. These efforts can leverage comprehensive project databases, including the Mercator Institute for China Studies' [Belt and Road Tracker](#), American Enterprise Institute's [China Global Investment Tracker](#), and the Center for Strategic and International Studies' [Reconnecting Asia](#) database.

II. Investment Facilitation

Recommended Actions

- **Make investment retention a priority in the region.** Working through regional organizations and bilateral channels, the United States and Australia should emphasize the importance of regulatory transparency, good governance, and aftercare services in investment decisions. Reforms should include streamlining and digitizing business registration, better integrating foreign companies into local economies, harmonizing federal and state-level regulations, and ensuring the rule of law. The United States and Australia should support capacity building measures, such as seminars, to train local officials and help implement these reforms, especially in federated countries with various state and local levels of regulations.
- **Use regional organizations to raise investment standards and set best practices.** The United States and Australia should support pathfinder initiatives in the Asia-Pacific Economic Cooperation (APEC) forum, such as reviews into competition laws and state-owned enterprise policies for APEC members and new financing options such as asset recycling to attract new investment. Additionally, both countries should work within APEC's committee on trade and investment to set quality investment principles for the region based off those from the Korea-U.S. Free Trade Agreement (KORUS) and the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP).
- **Partner with and expand sub-regional private sector initiatives.** The United States and Australia should work with local business councils and sub-regional public-private partnerships, such as the Australia-led Mekong Business Initiative, ADB's Greater Mekong Subregion initiative and U.S.-led Lower Mekong initiative. These programs allow for localized information sharing and exchanging of technical expertise. Specific geographic areas of focus could include Vietnam, which is working with the World Bank to draft a [new FDI Attraction Strategy](#), and Indonesia's Batu, West Java, and Central Java [special economic zones](#).
- **Actively shape the investment facilitation agenda in the World Trade Organization (WTO).** The United States should join Australia in signing the [WTO Joint Ministerial Statement on Investment Facilitation for Development](#). This accord affirmed the importance of transparent and predictable investment regulations; U.S. involvement in future discussions would ensure these goals are maintained. By participating in this working group, the United States can shape outcomes in a future agreement that reflect shared U.S. and Australian interests in the Indo-Pacific.
- **Promote full implementation of the WTO Trade Facilitation Agreement (TFA).** The United States and Australia should encourage countries in developing Asia to quickly adopt their TFA commitments to reduce bureaucratic delays and regulatory "red-tape." Countries should prioritize implementing articles I and II of the agreement, which require signatories to promptly publish information about new regulations and allow investors to comment on proposals for relevant laws and administrative regulations. Improving transparency and ensuring foreign companies

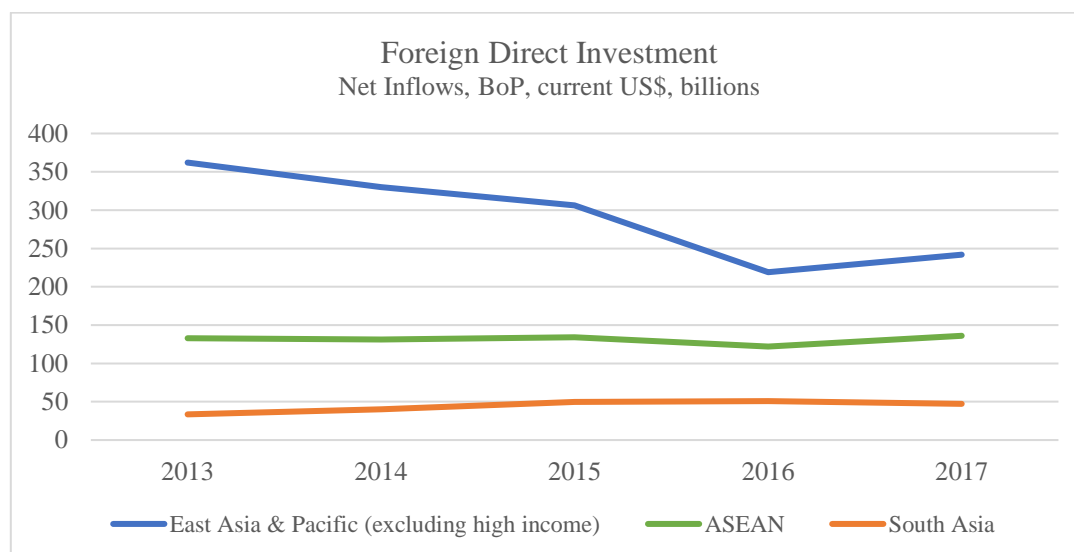
can participate in the regulatory writing process will improve reduce political risk and uncertainty.

The Challenge

Investment is a key driver of economic growth. Investment-led development over recent decades has transformed Asian economies and lifted billions out of poverty. Over this time foreign direct investment (FDI) has become a crucial source of financing. In 2017, 33 percent of global FDI was directed to developing Asia, the largest recipient region in the world ([UNCTAD](#)).

Increased FDI brings benefits to both host and source countries. In recipient economies, foreign investment can accelerate productivity gains; create stable, well-paying jobs; and help local firms adopt international best practices to improve efficiency ([World Bank](#)). For example, Samsung products accounted for nearly a quarter of Vietnam’s total exports in 2017 ([The Economist](#)). Companies investing abroad become more competitive and often reinvest their profits at home, promoting growth in source countries. Increased FDI flows, along with trade, also reduce the likelihood of armed conflict between countries ([Polachek et al, 2007](#)).

There is still a need for investment in Asia, especially in infrastructure. The Asian Development Bank (ADB) projects that developing Asia will need to invest \$1.5 trillion a year in infrastructure from 2016 to 2030 to maintain growth momentum and continue progress in eradicating poverty ([ADB](#)). The region currently invests about \$900 billion annually, leaving a \$600 billion financing gap.



Source: [The World Bank](#)

Countries in the region have implemented various programs to attract foreign investors, including reducing limits to foreign ownership in certain industries and streamlining approval and registration processes ([World Bank](#)). For example, Indian Prime Minister Modi’s “Make in India” initiative prioritizes liberalizing regulations ([Economic Times](#)) and Myanmar’s 2017 New Companies Law allows foreign investors to own a greater share of local companies ([ASEAN Briefing](#)). Association of Southeast Asian Nations (ASEAN) member states have used tax breaks and other incentives to promote new investment, including tax holidays and reducing corporate income tax for foreign companies ([NTRC](#)). Ratification and

implementation of the CPTPP will further improve the investment climate by establishing protections and dispute settlement processes for investors, as well as increasing regulatory certainty ([CSIS](#)).

Despite this progress, persistent barriers to FDI remain and investment growth has stagnated in parts of the region. While business sentiment towards ASEAN countries is broadly positive, investors continue to report dissatisfaction with high levels of corruption and non-tariff barriers to trade ([Chamber of Commerce](#)). As a result, fewer U.S. companies said they plan to expand into one or more ASEAN countries in 2017 than in 2016. Similarly, the 2017 U.S.-China Business Council member survey found that unfair competition with domestic firms, burdensome regulations, and intractable investment barriers continue to limit market access and investor confidence in China ([USCBC](#)). 40 percent of respondents were less optimistic about the business climate in China than three years ago and only 11 percent were more optimistic. In India, FDI growth slowed to a five-year low of 3 percent in 2017 despite reforms ([IDIPP](#)).

While countries in developing Asia have made progress in attracting initial entry of foreign companies and managing exits, there is a need for policies to improve investment retention and the local business climate once a deal is announced. The World Bank's [2018 Global Investment Competitiveness Report](#) surveyed 754 business executives and found that political stability and business-friendly regulatory regimes are the most important factors behind new investment decisions. Protections against political and regulatory risk are far more important than tax or other financial incentives, especially for market-seeking actors ([World Bank](#)). [Perceptions of corruption in the public sector](#) have improved in parts of developing Asia (like Indonesia and Vietnam) but are typically off a low base. Although reform priorities vary slightly across the region, policies that improve governance, streamline regulations, and enforce the rule of law are crucial to attract and retain foreign investment.

Alongside these reforms, developing countries will need to address domestic concerns about how the economic gains from FDI are distributed to maintain political support. Adjustment assistance programs can mitigate some of the potential short-term disruptions from FDI. The argument needs to be made by governments in developing countries that FDI creates jobs and lifts domestic asset prices and wealth. Countries can learn from each other to implement successful policies that expand prosperity and create domestic political support for investment, like Brazil's Bolsa Familia program ([IBRD](#)).

In sum, investment is a key component of growth in developing Asia, and FDI is playing a larger role in development. While the region faces a large financing gap, barriers to foreign investment, especially political and regulatory uncertainty, are preventing countries from unlocking their full growth potential. Generally, countries with a more robust rule of law [attract higher rates of FDI](#).

U.S. and Australian Engagement

The United States and Australia are heavily invested in developing Asia. The United States is the largest investor in ASEAN, with a stock of over \$306 billion in investment by 4,700 companies in the region, and is the second-largest investor in India ([Chamber of Commerce/Bloomberg](#)). Australian investment in Asia has increased rapidly over the past decade as well, albeit from a small base. Australian investments in East and South Asia

nearly quadrupled between 2007 and 2017, led by projects in Japan and Hong Kong ([DFAT](#)). The stock of investment between Australia and ASEAN was \$224.4 billion in 2016 – greater than that between Australia and China ([Austrade](#)).

FDI flows to ASEAN, 2016 (USD, millions)

	FDI flows to ASEAN	Rank
European Union 28	30,465	1
Intra-ASEAN	23,948	2
Japan	13,989	3
United States	11,657	4
China	9,211	5
Republic of Korea	5,890	6
Australia	3,433	7

Source: [ASEAN Investment Report 2017](#)

The United States and Australia are aligned on key principles in the Indo-Pacific, including promoting quality investment. The joint statement between President Trump and former Prime Minister Turnbull in February 2018 emphasized the importance of promoting a free, open and rules-based Indo-Pacific ([White House](#)). Both countries pledged “to continue to use diplomacy and assistance to support good governance and smart development decisions in the region.”

Washington and Canberra have already deepened bilateral channels of collaboration this year to realize this shared goal. In February, The U.S. Overseas Private Investment Corporation (OPIC) and Australia’s Department of Foreign Affairs and Trade signed a MOU on joint investment in the Indo-Pacific. In July, OPIC announced a trilateral partnership with Japan and Australia on economic cooperation, providing a formal foundation for future projects ([OPIC](#)).

The Trump administration’s “free and open Indo-Pacific” strategy seeks to establish an open and rules-based system to govern investment across countries by harnessing private sector investment to finance and promote sustainable development ([White House](#)). As part of this initiative, the U.S. announced new cooperation efforts with Japan, India, and Australia and reaffirmed support for regional institutions. On July 30 Secretary of State Mike Pompeo announced \$113 million of investment in technology, energy, and infrastructure assistance as a “down payment on a new era” in U.S. economic engagement with the region ([Reuters](#)). As part of the revised South Korea-U.S. free trade agreement signed in September, the U.S. and South Korea agreed to establish panels to monitor investment issues and ensure transparency and due process, using similar language to that in the Trans-Pacific Partnership ([USTR/Inside Trade](#)).

The Trump administration also recently signed the Better Utilization of Investments Leading to Development (BUILD) Act into law, which will expand U.S. development finance capacity. This bipartisan legislation will consolidate several U.S. development agencies under a single entity and expand capabilities. The new organization will be able to make equity investments and will have a contingent liability ceiling of \$60 billion – double the current amount. ([Brookings](#))

Australia has taken a more active approach than the U.S. on strengthening investment standards through bilateral and regional trade agreements. The 2010 ASEAN-Australia-New Zealand Free Trade Area set baseline principles by establishing legal protections for investment in ASEAN. It was the first comprehensive agreement signed by ASEAN and included the first binding investor-state arbitration procedures. Once it has come into force, the Australia-Indonesia FTA will further improve the bilateral investment climate by simplifying regulatory procedures, implementing high-quality rules, and lifting foreign ownership caps ([DFAT](#)). Canberra has been a strong proponent of CPTPP and also has taken a leading role in the South Pacific, working within the Pacific Islands Forum to strengthen investment standards ([Lowy Institute](#)).

The United States has avoided including a general investor-state dispute settlement provision in the new US-Mexico-Canada Agreement. There is significant opposition to ISDS in many countries, even with the most recent reforms that include health and environment policy exceptions. If the investment facilitation agenda progresses at the multilateral level without ISDS, it remains important to find avenues for resolution between investors and host countries where legitimate differences in implementation arise.

The Opportunity

While countries in developing Asia have gotten better at investment promotion and managing disputes, investment retention and stewardship practices are underdeveloped. These policies, which reduce political risk and uncertainty, can have the greatest added value, especially as if they are tailored to different types of investors (market-seeking, efficiency-seeking) and at different points in the investment lifecycle ([World Bank](#)). Many of these are straightforward to implement, like digitizing the filing and registration process. This reduces both the time required to open a business or complete a transaction and the opportunity for corruption, since companies will interact with fewer officials directly.

The United States and Australia agree on investment regulation best practices and can leverage their strategic and economic strength to improve investment standards in the region. Washington and Canberra can emphasize the importance of transparent, business-friendly regulatory environments during trade agreement negotiations and other bilateral discussions. For example, the investment chapter of the China-Australia Free Trade Agreement is up for modernization, presenting an opportunity to strengthen investment rules. Similarly, Vietnam is drafting a new [FDI Attraction Strategy](#) with the World Bank, presenting an opportunity for the United States and Australia to help codify best practices.

Washington and Canberra also enjoy agenda-setting power in regional forums and organizations, such as APEC, the East Asia Summit (EAS), and the ADB, where they should expand the discussion on investment facilitation. Through these forums, the United States and Australia should encourage other stakeholder participation in the process. An organic consensus is more likely to develop if more countries, including key economies like China, are involved in the discussions. Japanese [investment principles](#), outlined by Prime Minister Abe in 2017, could be a starting point for discussions.

Pathfinder initiatives organized through APEC can build support at a plurilateral level, paving the way to a wider agreement. For example, a pilot program could work with member states to commit to initiatives that improve their World Bank ease of doing business score, to

be administered by the APEC Economic Committee. This would improve regional investment climate by supporting different policies tailored to individual country priorities. An alternative program could use the U.S. Department of Commerce's [SelectUSA](#) program as a model for harmonizing federal and local regulations to encourage investment. These principles could be integrated into existing programs, such as the Philippines' [Public-Private Partnership Center](#).

The United States and Australia are among the world's largest direct investors and boast two of the most dynamic private sectors in the world. By sharing technical knowledge through seminars and working with business councils in a public-private partnership, both countries can offer an alternative to lower-quality investment in the region. Public-private partnerships also function to convene and organize business interests around common goals. This could spur a virtuous cycle as countries in developing Asia compete to streamline regulations to attract private investors. Initial efforts can focus around supporting special economic zones in the region, such as Indonesia's West Java and Central Java regions. There is significant scope to trial asset recycling in emerging economies in the region as a way to expand financing, drawing off Australia's experience and working with the [IFC Asset Management Company](#) and multilateral development banks.

Both countries should also play an active role in shaping the WTO investment facilitation agenda. In December 2017, 70 WTO member states accounting for 66 percent of inward FDI, including Australia, China, and the European Union, signed a [Joint Ministerial Statement on Investment Facilitation for Development](#). This recognizes the need for close international cooperation to "create a more transparent, efficient, and predictable environment for facilitating cross-border investment." The United States should sign on to this accord to ensure these goals are met in any final agreement. Without U.S. involvement, other countries will shape the agreement and it may not align as closely with U.S. and Australian interests.

Finally, Washington and Canberra should encourage WTO member states to quickly implement their commitments in the Trade Facilitation Agreement, which entered into force in February 2017. The WTO estimates its full implementation could reduce trade costs by 14.3 percent and increase global trade by over \$1 trillion a year by cutting "red tape" and simplifying bureaucratic procedures ([WTO](#)). Articles I and II of the agreement (availability of information and consultation rights) will improve the investment climate by increasing transparency and allowing foreign stakeholders to participate in the regulatory writing process.

III. Energy

Recommended Actions

- **Make well-functioning domestic energy systems a priority in the region, through APEC and the G20.** Working bilaterally and in the Asia Pacific Economic Cooperation (APEC) forum, East Asia Summit and the G20, the United States and Australia should highlight the importance of well-functioning domestic energy systems to prosperity and inclusive development across the region. These systems are complex, in terms of the combined impacts of technological change, segmentation of domestic generation, transmission and retail energy markets, non- and anti-competitive behavior by private- and public-sector participants, energy infrastructure decisions, changing consumer preferences, and government policy. Understanding and addressing these complexities is essential to ensure the domestic supply of reliable, secure, affordable and sustainable energy. The United States and Australia provide good cases of policy successes and failures, which should be explored with other countries' experience to develop case studies and good-practice guides in the development and regulation of domestic energy systems.
- **Accelerate a stable energy transition in the region, through ASEAN and APEC.** Drawing on the know-how of business, think tanks and the International Energy Agency, the United States and Australia should work closely with ASEAN, China, India, Japan, and Korea on understanding the impact of rapid changes in technology on energy supply and demand and the opportunities this provides to transform energy systems. Targeted second-track discussions between business and government within the region on energy technology should include the opportunities for improving the efficiency, cost and sustainability of fossil-fuel power generation, emerging renewables technology, the stable integration of renewables into the grid, carbon capture and use, energy demand management that supports economic growth, energy efficiency, and energy security in remote locations (with this last area including some Pacific Island states). Use discussions to explain developments and changes in domestic energy environments and policies, to improve the success of the energy transition.
- **Lift public confidence in the sustainable extraction of gas, starting with small group workshops.** Working bilaterally and with relevant countries like China, India and Indonesia the United States and Australia should highlight the importance of public confidence in the safe extraction of non-conventional gas and impact on ground and surface water. The United States and Australia have significant experience in the hydro-geology and the extraction of shale, coal-seam and tight gas, strong [science-based regulatory regimes](#) to underpin public confidence, and established methods to reduce fugitive emissions. Maintaining broad consumer confidence in the environmental and water impacts of non-conventional gas extraction is important to ensure the long-term viability of the market; informal track-two workshops and dialogue also provide new commercial opportunities for extraction and related business services in the region, with appropriate protection of intellectual property.
- **Deepen regional gas markets to underpin energy security in the Indo-Pacific, through APEC Energy Ministers.** Working with key partner countries in Asia, the

United States and Australia should explore practical steps to develop and grow spot markets in gas across the region, to complement long-term contract markets. Australia has a deep extensive network of long-term gas contracts with Asian economies that are essential to the region's energy security and prosperity, and the United States is a significant emerging gas exporter to the region, on track to become the third largest LNG exporter after Australia and Qatar in the next few years and the largest exporter of LNG in the mid-2020s. The [International Energy Agency](#) forecasts use of natural gas will rise by 45 per cent between 2016 and 2040, much of it in China and India, and deep and transparent spot gas markets—along with long-term contracts—provide assurance to buyers and sellers of gas that additional gas is available to meet peaks and underpins confidence in gas as a long-term energy source. The United States and Australia should support steps underway in the region, such as data collection, reporting and digital portals, and potential locations for a gas hub. This reform is an opportunity for the United States and China to work together in developing a stable market that meets the fundamental needs of both countries and the region more broadly, and expands the portfolio of cooperation between the two major powers.

- **Accelerate reform of the focus and governance of the International Energy Agency (IEA), under the auspices of APEC Energy Ministers.** Working closing with China, India, Indonesia, Japan, Korea and Singapore and in the G20, the United States and Australia should stress the need for effective global energy arrangements and pursue continued reform of the IEA. The essential features of an effective global institution include addressing global security of supply across major energy sources traded across borders (not just oil but also gas, coal and uranium), embedding the role of open, transparent, well-functioning, and well-regulated markets as a path to energy security, and engaging major Asian economies in international decision-making on energy and as essential partners in the global energy transition.

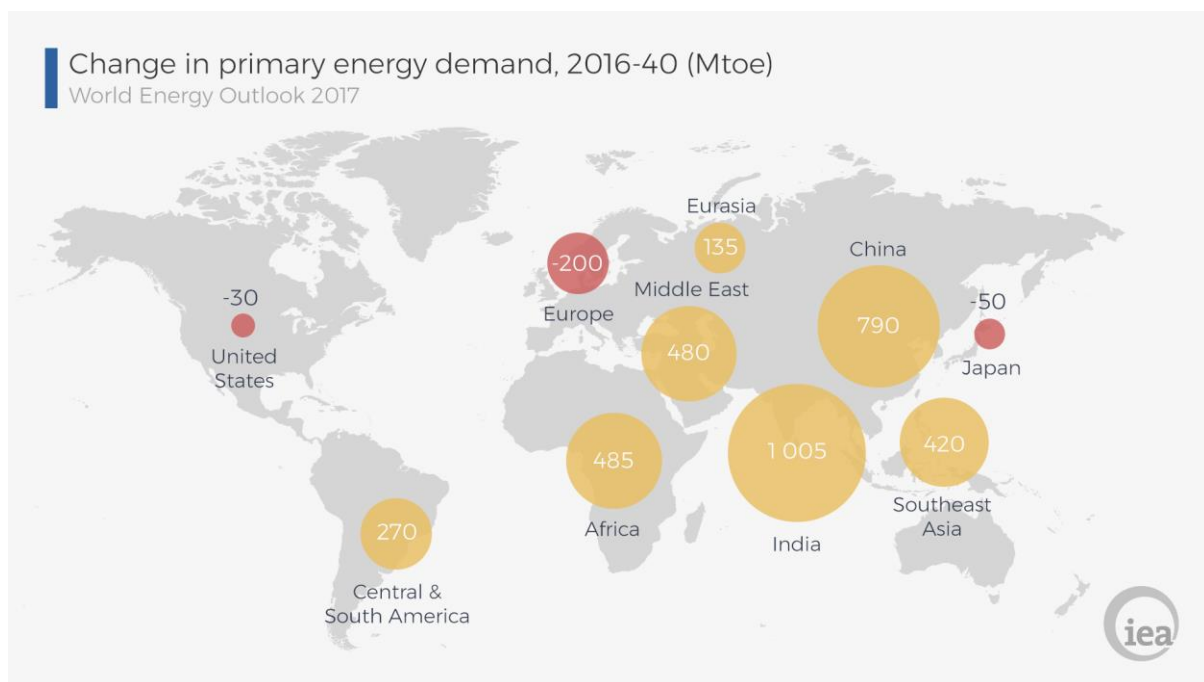
The Challenge

Energy, especially electricity, matters a lot to economic growth and the quality of people's lives. The world produced 25,679 Twh of [electricity](#) in 2017, two-thirds from combustible sources, with a quarter of the world's electricity generated in China, followed by the United States (17.2 per cent) and India (5.9 per cent). The [International Energy Agency](#) predicts that power demand will rise by a further 30 per cent from 2017 to 2040, “the equivalent of adding another China and India to today's global demand”, underpinned by global growth, population increase (from 7.4 to over 9 billion) and urbanization. Much of this increase will happen in India, Southeast Asia and China, adding the equivalent of existing U.S. electricity infrastructure in China and E.U. electricity infrastructure in India by 2040. Energy poverty is still widespread, but access is improving – at the rate of 100 million people a year since 2012 – but over a billion people around the globe still lack access to electricity and many more rely on combustible material for cooking that is harmful to health.

The starting point is getting the domestic energy system right. This is complicated. The typical economic and social objectives for energy encompass reliable and secure supply, affordability and sustainability. The big drivers of supply and demand are undergoing fundamental change – technology is shifting the cost of new generation of electricity in favor of renewables and clean sources of power, which is being reinforced by household and business preferences for greater control over power bills and for renewables. Innovation and

effective competition are needed in each of the segments of the domestic energy system – energy sourcing and electricity generation, distribution and retail – reinforced by good regulation and enforcement. For remote locations or small Island states, stand-alone small-scale solar and wind generation is needed. The sources of energy are undergoing major change, particularly in the global gas market, and the use of chemicals in domestic unconventional gas extraction and impacts on water and farmland need to be well understood and regulated. And the increasing share of renewables in electricity generation needs to be managed in a way that ensures reliability and security of supply, often achieved by a combination of dispatchable power (like gas or hydro), storage (battery or hydro), underpinning baseload, and demand management and technical solutions. This all needs to be put in the context of each country’s geography, resource endowments, approach to markets, security arrangements, structure of government (particularly federal systems), and changing physical environment due to climate change and urbanization.

The private sector is a key partner in bringing new technology to the sources of energy and to generation and transmission of electricity across emerging Asia, and to the energy transition underway across the whole region. This expertise includes: safer extraction of energy sources, including the impact of unconventional gas extraction on surface and ground water, farmland and cities; using technology to improve the efficiency, operating cost and pollution of existing coal-fired generators; building new significantly more efficient and clean coal and gas generation; state-of-the-art wind and solar generators and storage systems; and data management systems which enable a significant step up in system management. U.S., Japanese and Australian businesses have a lot to offer the region.



Source: [International Energy Agency](https://www.iea.org/)

The sources of supply of energy across the Indo-Pacific, and indeed globally, are changing significantly, especially in gas. The [IEA](https://www.iea.org/) predicts that global gas use will increase by 45 per cent from 2016 to 2040, driven largely by demand from China and India as part of coal replacement strategies, and the expansion of supply from the United States, which is set to become the third biggest exporter of liquified natural gas (LNG) as a consequence of its

shale gas revolution. Even in the next few years, LNG trade is expected to increase from 290 million tons in 2017 to 365 million tons in [2020](#). The LNG market itself has been changing rapidly [over the past decade](#), with the rise of portfolio players rather than just “point-to-point” gas traders, shorter duration of contracts and growing spot trade, decline of oil-linked pricing of gas, more flexible terms and conditions in contracts (allowing destinations to vary and resale) and the development and expansion of floating regasification plants in gas-importing countries. The Asian market is not supported by a [gas trading hub](#), unlike the hubs that exist in the United States (Henry Hub) or Europe (National Balancing Point and Title Transfer Facility), and large purchasers of LNG in Asia have raised the possibility of establishing an Asian LNG hub to support price discovery and trade, including greater development of a futures market to better manage risk.

More generally, the international governance arrangements around energy – centered on the OECD-based International Energy Agency – have been changing but have struggled to keep up with the monumental changes in global energy markets, both in terms of the coverage of major energy sources traded across borders (not just oil but also gas, coal and uranium) and the participation of major Asian economies in international decision-making on energy and as essential partners in the global energy transition. The IEA has been successful in extending its data and analytical work to include non-oil energy sources and renewables in the electricity generation mix, but its primary cooperation mechanisms are based on oil, a declining part of the global energy mix. There is scope for structured discussions on shocks or disruptions to all sources of energy, how scenarios could play out, and possible forms of cooperation between affected countries, at the bilateral, regional and global level. The IEA has sought to bring in major Asian emerging markets as “associate members” of the organization but not yet as full decision-making members. The IEA is bound by OECD membership requirements, with disproportionate weight given to small European countries, and emerging markets have different views about the value of full membership.

U.S. and Australian Engagement

Both the United States and Australia are focused on domestic energy reform in their own countries. Both countries have grappled with a changing energy mix where coal is a major power source, with the development of the shale gas dramatically shifting fuel to gas in the United States, while the rapid growth of wind and solar power, including household solar, has significantly lifted renewables generation in Australia. Both countries have struggled with the integration of renewables into the grid, especially in Australia, and to find an enduring balance for the public policy objectives of affordability, reliability and stability, and sustainability of the power mix. Both are federal systems with complex governance arrangements associated with market operation, rule-setting, rule enforcement and ministerial oversight.

The United States is historically an energy importer, and its strategic and economic focus over many decades has been oil security, with cooperation in managing oil stocks within the IEA an important tool to stabilize that market in the face of major supply disruptions. That imperative has shifted over the past decade, as renewables and, most particularly, domestic shale gas have expanded. The United States is poised to become the third largest LNG exporter in the next year or so, with nameplate or potential capacity of U.S. LNG projects expected to triple to 70 million tons a year after six new gas liquification and export plants come on line in 2019, close to Australia which will have nameplate capacity of 88 million

tons and Qatar which will have nameplate capacity of 77 million tons at that time. The U.S. emergence as a major supplier of LNG has been rapid – [up from 2 million tons in 2016 and 10 million tons in 2017](#) – and has [accelerated](#) the changes in the global gas market.

Australia is a major resource commodity and energy exporter, including coal, uranium and gas, but is a net importer of oil. Almost half of [Australia's LNG](#) exports go to Japan, followed by China (34 per cent) and South Korea (12 per cent), and is sourced from natural gas and coal seam gas. Long-term contracting has been essential to the development of gas projects in Australia, given the remoteness and scale of the resources. Prices have been traditionally linked to oil, largely to provide pricing certainty to buyers and sellers in a nascent industry and enable hedging in deep futures markets, but this is likely to shift as exports of U.S. LNG, which is priced in Asia at Henry Hub plus liquefaction and transport costs, rise.



Source: PETER PARKS/AFP/Getty Images

Both Australia and the United States are active in the energy clusters of APEC and the G20. The APEC Energy Working Group was established in 1990 and meets twice a year at officials' level with four areas expert groups on energy efficiency, clean fossil fuels, new and renewable energy technology, and energy data and analysis. Ministers meet every two years but have not met since 2015. The G20 Energy Transitions Working Group addresses the priorities of the G20 presidency, with recent priorities being energy access (China, 2017) and flexible, transparent and cleaner energy systems (Argentina, 2018); Japan is president in 2019 and may focus on new technologies and energy sources like hydrogen as paths in the energy transition.

The Opportunity

The United States and Australia have an unparalleled opportunity to influence the change and transformation of domestic energy systems and international energy trade in a way that supports prosperity and security in each of the two countries as well as across the regional and globally.

In February 2018, the President and Prime Minister formalized U.S.-Australia bilateral energy cooperation in the Australia-United States Energy Partnership in the Indo-Pacific (AUSEP), with the first Energy Security Dialogue (ESD) held under AUSEP on October 2, 2018. Drawing on AUSEP and informed by the ESD, the United States and Australia should work closely together with key countries to re-invigorate the international forums and institutions for cooperation on energy matters and achieve substantive outcomes that support stable energy transition.

At the regional level, the United States and Australia should work with key partners, including China, Japan, Korea and Indonesia, to lift the focus of the APEC Energy Working Group from projects and administration to strategic matters such as the energy challenges and opportunities facing the region, energy transformation and transition, and the role of well-designed frameworks and markets to deliver prosperity and security. This requires re-instituting the energy ministerial meeting with a strategic agenda. This strategic agenda should include:

- frank and open discussion about the importance of well-designed domestic energy systems, using examples of success and failure to develop case studies and good-practice guides in the development and regulation of domestic energy systems;
- practical conversations about the energy transition underway and the opportunities provided by technology, including with the private sector and relevant think tanks, taking the integration of renewables in the grid and the upgrading of fossil-fuel generation as two early practical examples, [with ASEAN a great partner in this conversation](#);
- agreement on the role of effective markets to underpin prosperity and security in the region, including practical steps to develop deep and effective spot and long-term contract gas markets in Asia;
- improving global energy market governance through reform of the International Energy Agency, particularly around membership of the IEA, fuel types and coverage of issues that matter to countries in the Indo-Pacific;
- presenting an energy agenda to APEC leaders that supports a stable energy transition and meets the individual and collective economic and security needs of countries in the Indo-Pacific, at a time of heightened tension between major powers.

The United States and Australia should take a flexible and pragmatic, yet ambitious, approach in working with the APEC Energy Working Group as the overarching mechanism for regional cooperation on energy in the Indo-Pacific. Two points are worth making.

First, work under the auspices of APEC can be advanced by pragmatic pathfinder or sub-regional working groups, including with countries, like India, or organizations, like ASEAN, that are not members of APEC (recognizing that expanded membership may be on the table). Gas market reform, for example, should comprise a working group comprising Australia, China, India, Indonesia, Japan, Singapore, South Korea and the United States. And practical conversations with the private sector on technology and the energy transition could initially focus on ASEAN, and Indonesia in particular, where the opportunities to improve the efficiency and cost of existing fossil-fuel generation are significant. Existing membership is a constraint, but it should not unnecessarily limit opportunities for dialogue and cooperation.

Second, energy is a matter in every country that has both fundamental economic and security dimensions. At a time when the global strategic power balance is becoming more multipolar, and tension between China and the United States is high (and rising), it is essential to develop a portfolio of interests, style of interactions and mutual dependencies between major powers. Reform of the Asian gas market, for example, is an unusual opportunity for China and the United States to work together in developing a stable market that meets the fundamental needs of both countries and the region more broadly, and includes spot and contract markets. All of the areas for reform of the energy system, markets and frameworks outlined in this chapter present an opportunity to expand the portfolio of cooperation and mutual benefit between China and the United States.

At the global level, the United States and Australia should work together in the G20 and the IEA for substantive policy and institutional reform, as outlined above. Both countries should actively engage bilaterally with regional energy partners, especially China, India, Indonesia, Japan, South Korea and Singapore.

IV. Digital Economy

Recommended Actions

- **Strengthen principles and best practices for regulation of digital commerce in the region using APEC.** Countries in developing Asia are still debating what their national digital governance regimes will look like. The United States and Australia should work with likeminded regional partners, including Japan, India, and Indonesia, to develop and harmonize principles that ensure a free and open internet and cross-border data flows. Best practice regulations for data usage, transfer, privacy, and storage should be codified in regional organizations, such as the Asia-Pacific Economic Cooperation (APEC) forum's [Electronic Commerce Steering Group](#). These should be based off those negotiated in the original [Trans-Pacific Partnership](#) (TPP), which many APEC members have already agreed to.
- **Invest more in deploying and governing critical emerging technologies, including through cooperation with Japan, ASEAN and India.** Market leadership for future technologies, including 5G, is up for grabs. The United States and Australia should redouble their efforts in critical trade groups, including the [3rd Generation Partnership Project](#), to build international consensus concerning governing critical technologies. Both the United States and Australia should develop a comprehensive strategy that engages with partner countries to maintain a competitive private sector, market principles, and privacy in the emerging technologies space. The conversation around Huawei 5G technology and related security and economic implications requires a sober examination. As concerns about the use of private 5G technology grow, Australia and the United States should promote public understanding of the benefits and risks of 5G, how best to realize benefits, and different ways risks can be mitigated.
- **Deepen engagement at the World Trade Organization (WTO) to reach agreement on digital commerce rules.** [As of January 2019](#), 76 WTO members, led by the United States and Australia, have signed the [Joint Statement on Electronic Commerce](#) to advance “open, transparent, non-discriminatory, and predictable regulatory environments” for digital commerce. This agreement established a working group process, which the United States and Australia should continue to lead. Both countries should explain the value of the agreement, especially for consumers, and focus on pathfinder initiatives that can lead to a plurilateral ecommerce agreement. Ultimately, these should seek to revive broader WTO negotiations on ecommerce, which stalled in December 2017.
- **Strengthen digital infrastructure to connect individuals to the global trading system, starting with workshops in ASEAN and India.** There is a persistent digital divide in developing Asia, where in some countries less than [30 percent](#) of the population has internet access. Rates of broadband penetration are even lower. The United States and Australia should help bring more of developing Asia online through publicly funded projects and private sector investment. Not only will this help the region meet its growth potential and create positive spillover effects, it will help spread digital governance best practices.

- **Help small businesses take advantage of digital trade and compete in global markets, working with others in APEC and the G20.** Small- and medium-sized enterprises (SMEs) face several barriers to fully participating in digital trade beyond an understanding of the value of digitization and connectivity issues. Customs duties, patchwork regional regulatory frameworks, restrictive regimes and all impact SMEs more than larger companies, which have more legal resources. Working within APEC, the G20, and regional and local business fora, the United States and Australia should promote small-business-friendly policies, such as eliminating tariffs on digital products.
- **Share policies and experience on worker retraining and improving labor mobility, initially through a workshop with ASEAN.** Technological advancement creates rapid growth but also short-term displacement effects. Well-crafted policies that provide worker retraining and improve labor mobility can ensure broad access to the opportunities provided by technology. The United States and Australia should share technical expertise with developing Asian countries to help smooth the transition to the internet economy, build human capital in the region, and expand the talent pool available for SMEs.
- **Deepen cooperation in defending against cyber threats, starting with informal workshops with ASEAN.** Cyber security is an essential component of national security, and the United States and Australia should collaborate where possible to minimize risks. This includes ensuring countries are abiding by cyber espionage agreements. Best practices to ensure a free and open internet should align with national security strategies to facilitate interagency policy coherence.

The Challenge

The digital economy is growing at a staggering rate. Since 2010 the global internet-using population has more than doubled, and more than [4 billion](#) people are now connected to the internet. By 2019, the volume of global internet traffic will be [66 times](#) higher than it was in 2005. Some of the fastest rates of adoption have been in the Indo-Pacific region, where more than half of the world's internet users are located. People are also spending more time on the internet; the average user spends about [six hours](#) per day online.

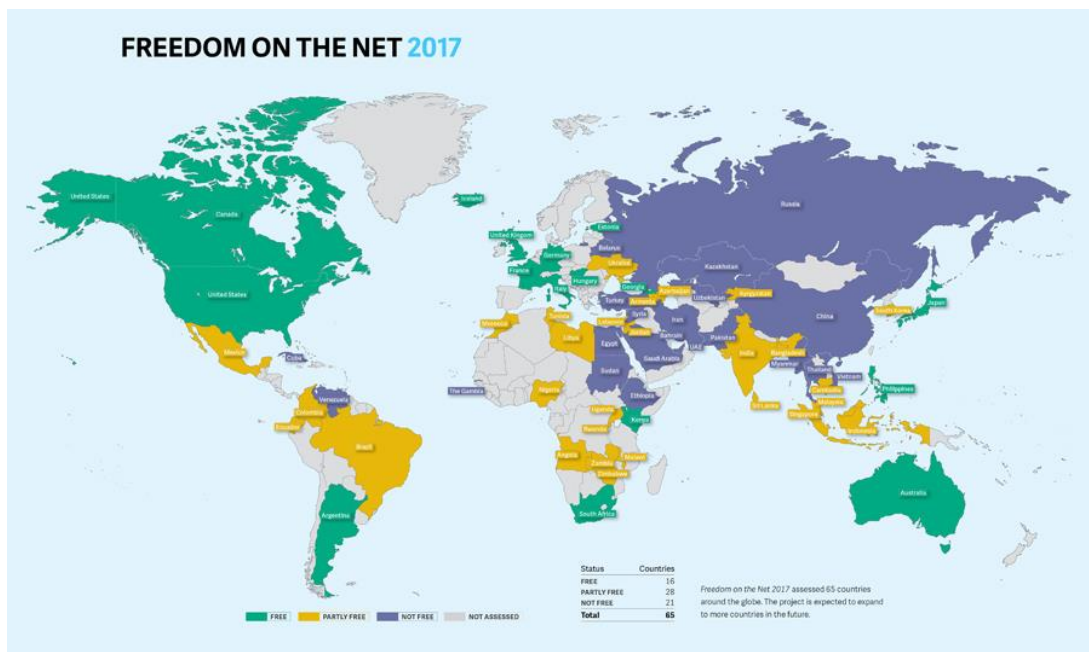
This expansion has transformed societies and created new economic opportunities. The internet economy [accounted](#) for 6.5 percent of U.S. GDP in 2016, or \$1.2 trillion, growing at 5.6 percent from 2006 to 2016 and outpacing overall growth of 1.5 percent. Some of the fastest growth prospects are in developing Asia. Google [predicts](#) the internet economy will account for 6 percent of Southeast Asian GDP in 2025, up from 1.3 percent in 2015, and the Boston Consulting Group [expects](#) India's internet industry to double from 2016 to 2020.

In response to this phenomenon – and in some cases to push back on U.S. dominance of cyberspace – countries are regulating the internet, occasionally clashing with fundamental market principles, and seeking to develop home-grown digital standards and businesses. For the first time, there is a competing vision to the free and open internet. The stakes are high. There is competition for global digital rules. At best, this will create a patchwork of different regulations that will inhibit the free flow of data, slow international commerce, and stifle

innovation. At worst, it could lead to the “balkanization” of the internet with certain spheres that limit personal freedoms and economic opportunities.

The core rules at stake are those governing the free flow of information, intellectual property (IP) protection, internet sovereignty, national security, and individual privacy rights. Roughly [90 percent](#) of the data ever produced in world history was created in the last *two years*. In 2016, [80 terabytes](#) of data entered and left the United States every minute, equivalent to eight times the print content of the Library of Congress. Internet users rely on this information to exchange ideas, start businesses, and provide services. Preventing the free flow of data would hurt the global economy and disproportionately impact small- and medium-size enterprises (SMEs) that do not have the resources to adapt to restrictions. Similarly, rules that weaken IP rights, impose data localization, and undermine consumer privacy would give governments greater control over businesses and individuals.

In the absence of strong global leadership on these issues, countries have implemented laws that restrict internet freedom. The European Union is moving to regulate cyberspace for privacy, security, and anti-competitiveness. China has developed an extensive cyber governance regime centered around its [Cybersecurity Law](#), which took effect in June 2017. Other countries have taken similar measures to enforce data localization and increase censorship. [Vietnam](#), [Tanzania](#), and [Nigeria](#) all passed recent laws that incorporate aspects that follow some of China’s example.



Source: [Freedom House](#)

Defining, through global technical standards, how emerging technologies will function, and work will also be a crucial area of focus. 5G technology will unlock a generational increase in processing power and will enable artificial intelligence, automated vehicles, and the internet of Things (IoT). McKinsey [estimates](#) that artificial intelligence, just one technology enabled by 5G, will add \$13 trillion in output to the global economy by 2030. Technical standards are important because they will give certain companies a competitive advantage in future technology. In June 2018, more than 600 officials and telecom executives from around the world announced the first [standalone 5G global standards](#). China should be encouraged to

actively participate in the standard-setting process. The final rules should maintain a free and open internet and competitive market principles.

Beyond digital governance, challenges remain in bridging the digital divide in developing Asia and ensuring SMEs can participate in the digital economy. India has the second-largest online population, but its [internet penetration rates](#) are among the lowest in the world. Internet and broadband penetration rates also vary widely in ASEAN countries. Improving connectivity and affordability of these critical services will help the region harness its growth potential, creating positive spillover effects for global trade and productivity.



Source: ROMEO GACAD/AFP/Getty Images

Expanding digital infrastructure will help SMEs participate in the global trading system. [Digital uptake by SMEs](#), and particularly the use of cloud computing and apps, can dramatically help these businesses manage invoicing, payroll, marketing, stock and planning, and lift profitability and viability. Market access barriers and digital customs duties impact SMEs more than large companies, since smaller businesses do not have the legal resources or expertise to navigate complicated regulations. Countries in developing Asia have prioritized connecting SMEs to drive growth. For example, Indonesia has [pledged](#) to “digitally empower” eight million SMEs by 2020 by retraining civil servants to help businesses manage ecommerce operations and logistics.

Persistent labor mobility [challenges](#) and inefficient skills development programs in developing Asia limit the talent pool for SMEs and opportunities for individuals. Policies to improve human capital are necessary both to support digital progress and address anxieties about technological change and automation. These can include improving workplace skills retraining programs, streamlining labor market regulations, and providing short-term wage insurance. It will also be important to ensure that Australia and the United States lead on bridging the [digital gender divide](#).

The growth of the digital economy has also created cybersecurity risks. The cyber threat has evolved significantly, with the spread of [ransomware attacks](#), corporate espionage, and global cybercrime. State actors remain the greater threat, despite international agreements, including the [2015 UN Group of Governmental Experts Report](#) (endorsed by the General Assembly), [Budapest Convention on Cybercrime](#) and the 2015 [U.S.-China Cyber Agreement](#). The global cost of cybercrime [reached](#) \$600 billion in 2017, up from \$445 billion in 2014.

U.S. and Australian Engagement

The United States and Australia have cooperated to develop principles that protect a free and open internet. During the TPP negotiations, both countries agreed to two dozen foundational [guidelines](#) for the digital economy. These included: promoting a free and open internet; securing basic non-discrimination principles; enabling cross-border data flows; preventing localization barriers; barring forced technology transfers; protecting source code and intellectual property; protecting consumer privacy; and cooperating on cybersecurity threats.

Both countries have worked in multilateral institutions to promote digital governance based on these rules. In December 2017, the United States and Australia helped persuade 71 WTO member states, accounting for 77 percent of global trade, to sign a [Joint Statement on Electronic Commerce](#). This accord recognized the importance of “open, transparent, non-discriminatory and predictable regulatory environments in facilitating e-commerce” and established a working group to draft e-commerce rules. At the first meeting, members [agreed](#) to address consumer protection, data flows, and market access. In September 2018, the United States, Japan, and the EU [agreed](#) to work toward a broader e-commerce agreement combatting digital protectionism.

Despite the U.S. withdrawal from TPP, the Trump administration has continued to champion a free and open internet. The September 2018 [United States-Mexico-Canada Agreement](#) contains comprehensive chapters on IP and digital trade that mirror those agreed on in TPP and that could serve as a model for future free trade agreements. These include protecting strengthening patent and source code protection; prohibiting customs duties on digital products; ensuring cross-border data flows; and limiting data localization requirements. As part of its “free and open Indo-Pacific” strategy, the Trump administration has [pledged](#) investment to establish a Digital Connectivity and Cybersecurity Partnership to leverage the private sector to support regional digital infrastructure.

The United States has particularly focused on enhancing cybersecurity capabilities. In September 2018, the Department of Defense released the first [new cyber strategy](#) in three years. This reiterates the commitment to an open internet while emphasizing cyber defense and resiliency. Building on the 2015 strategy, this version takes a [more active tone](#) in combatting risks through active missions to defend cyberspace. The Department of Commerce is creating a collaborative anti-botnet strategy and the Department of State plans to create a new [Bureau for Cyberspace](#).

Throughout digital governance negotiations, the U.S. has tried to balance consumer privacy protections with ensuring the free flow of data across borders and business concerns. The U.S. led APEC’s [Cross-Border Privacy Rules](#) (CBPR) deliberation process and is one of six APEC members to align privacy laws with this framework. Australia is in the [process](#) of implementing CBPR principles but is still in the consultation stage. In January 2018, the U.S. became the first country to join APEC’s [Privacy Recognition for Processors](#) program to certify compliance with CBPR guidelines. Australia has not yet signed on to this protocol.

For its part, Canberra has established an [International Cyber Engagement Strategy](#) to champion an open, free, and secure cyberspace. This emphasizes the respect of human rights and democratic principles online and shared prosperity from digital trade. As part of this effort, Australia has focused on digital technology development. In July 2018, Australia

[committed](#) \$137 million to build and undersea internet cable connecting Australia, the Solomon Islands, and Papua New Guinea. Boosting connectivity in PNG and Solomon Islands will drive economic growth, and improve governance and security. Australia has also worked with the Business 20 and APEC Business Advisory Council to encourage public-private collaboration on digital trade and investment.

The Opportunity

The regulation of cyberspace is one of the defining issues of the 21st century. There is a global competition to set rules, standards, and norms in this critical area, and the United States and Australia need to offer a positive vision and digital regulatory framework. Maintaining a free and open internet is paramount to national security and economic prosperity.

The United States and Australia have agreed on basic principles for digital governance. Both countries have championed a free and open internet during TPP negotiations and at international institutions. Washington and Canberra must strengthen efforts to ensure the internet remains open to market competition and protects individual freedoms. In the process, they should improve internet and broadband connectivity in third countries and help SMEs participate in the digital economy.

The United States and Australia should work together with TPP signatory countries to integrate digital principles from the agreement into regional organizations in developing Asia. These will provide a common benchmark for countries as they develop their rules in this new area. For example, APEC's [Electronic Commerce Steering Group](#) has published a [Cross Border Privacy Rules System](#) to set data privacy best practices. Six members countries have aligned their domestic regulations with this framework. With U.S. and Australian leadership, in collaboration with regional partners such as Japan, this group should publish guidelines for data storage, transfer, and usage rules similar to those in the TPP. This framework can also build off bilateral initiatives that promote a free and open internet, such as the [Australia Indonesia Partnership for Economic Governance](#), which ended in February 2018.

Outside of regional organizations, Washington and Canberra should deepen engagement with the WTO to reach an agreement on ecommerce rules. Negotiations [stalled](#) in December 2017 after years of disagreement. In response, the U.S. and Australia convened member states and established a working group on electronic commerce. Now, this process will have to produce meaningful pathfinder initiatives that can attract wide support. Despite its flaws, the WTO remains a crucial norm-setting forum. U.S. and Australian leadership will be critical to produce results and revive the broader WTO discussion. To build trust with emerging markets in the region, some of whom want to ensure that their own local firms can grow and are not dominated by U.S. firms, it will be important to highlight the consumer benefits of rules and open markets.

The United States and Australia also share an interest in ensuring technical standards for emerging technologies encourage private sector competition. To ensure 5G develops with market-friendly standards, similar to 3G and 4G development and deployment, Washington and Canberra should champion the global effort with other 5G leaders to commit to market-friendly standards. This will require public-private partnership and a greater presence at

forums including the 3GPP, and continued engagement with China and others on the importance of privacy and security as digital use expands.

Finally, the United States and Australia should continue to emphasize digital infrastructure as part of their respective Indo-Pacific strategies. Other countries are using infrastructure projects to [push cyber governance rules](#) in the region by using loans with conditionality. By improving regional internet and broadband penetration in developing Asia, Washington and Canberra will help the region realize its vast growth potential and provide an alternative source of investment.

V. Financial Systems

Recommended actions

- **Make strengthening and deepening financial systems and capital markets across the Indo Pacific a priority in APEC and the G20.** Working with key countries, the United States and Australia should reinvigorate the APEC Finance Process and develop a new G20 working group on opening financial systems, developing and implementing sound regulation, strengthening domestic financial resilience, deepening local currency capital markets and strengthening market integrity through sharing information, technical assistance, staff secondments and phase-in programs. Stronger domestic financial systems and trade across the region will improve the resilience and strength of economies, provide new commercial opportunities across the region and help reduce excessive trade imbalances.
- **Expand trade in financial services to strengthen some of the world's largest financial markets, reduce trade imbalances, ease trade tensions and help Indo-Pacific economies liberalize their financial systems through increased competition.** The United States and Australia should support a new G20 agenda on financial services trade. They should support a stronger focus on data transparency, promoting sustainable debt and building financial infrastructure into regional initiatives that seek to boost trade — such as Belt and Road, the Asian Infrastructure Investment Bank and the Asian Development Bank — including payment systems, credit information, collateral registries and financial institutions. The United States and Australia should encourage all countries sign onto and implement the use of APEC's Asia Region Funds Passport.
- **Get ahead of the next crisis and reduce spillovers on the United States, Australia and others in the region, through the G20.** Working with others in the G20 and beyond, the United States and Australia should develop a timetable on the next phase of IMF reform in the G20, giving emerging markets a larger role in crisis prevention and crisis response by shifting more of the quota burden to underrepresented emerging markets, consistent with their increased contribution to the global economy. The United States veto power should be preserved, while increasing permanent funding for the IMF through larger quotas and ensuring the New Arrangements to Borrow remain a potent backstop. The G20 should develop ex ante guidelines on how the IMF would cooperate with institutions in Asia under different crisis scenarios and work with Asian economies to strengthen regional mechanisms in Asia.
- **Better integrate Asia into the global financial safety net and limit fragmentation of the global financial architecture.** As part of a deal to link the Asian safety net in the global system based on the IMF, the United States and Australia should advocate for a non-European Managing Director of the IMF after Christine Lagarde's term expires, with more seats on the IMF Executive Board for the emerging market economies (in addition to what was promised by the G20 in 2010) from the existing Board. Both countries should seek to reduce the market stigma from seeking IMF assistance to strengthen the institution by supporting an expansion of the IMF's precautionary lending facilities.

The Challenge

Asian financial systems are [much more resilient](#) than they were in the 1990s. Banks are well-capitalised. Supervisory frameworks are stronger. Exchange rates are more market determined and better able to absorb shocks, just as they have been in Australia and the United States. Inflation is much lower and large current account imbalances have narrowed. Increased macroeconomic credibility has given Asian economies more monetary and fiscal policy freedom.

But despite these improvements, many emerging economies remain vulnerable to shocks. The recent tightening of global financial conditions has highlighted this vulnerability, particularly in Argentina, Turkey, Indonesia and Myanmar. Some emerging markets are especially vulnerable to exchange rate risk due to a comparatively high share of foreign exchange debt relative to foreign exchange reserves. [Foreign investor exit](#) from local currency instruments has also put downward pressure on the exchange rate.

Asian capital markets [remain underdeveloped](#). Market forces play an insufficient role in Asian financial systems which are shielded from foreign competition, particularly in financial services. The demand for U.S. financial assets and barriers to foreign competition make the U.S. trade deficit and global imbalances [bigger than otherwise](#). Addressing these challenges will strengthen domestic financial resilience, reduce the frequency of crises, support market-access for U.S. and Australian firms, minimise negative spillovers onto the United States and Australia and reduce global imbalances.

By increasing foreign competition, expanding trade in services will be a critical part of liberalizing Asian financial systems. If services trade was as liberalized as goods trade, global trade imbalances would be halved, [according to the Bank of England](#). Increased trade in financial services will ease political tensions fuelled by excessive trade imbalances, advance trade liberalization and strengthen financial systems in the region.

But these reforms are difficult, long-run processes. They must be carefully timed and sequenced. Financial institutions, markets and systems need to be well regulated and their integrity maintained. Countries undergoing financial reform have a treasure trove of international experience to draw on in planning and implementing reform. If not implemented carefully, [financial reforms risk triggering crises themselves](#). Support for domestic reforms must, therefore, be complemented by international efforts to ensure an adequate global financial safety net to reduce the severity of crises, prevent contagion and reduce negative spillovers on the United States and Australia.

The [safety net consists of](#) global, regional and bilateral components which are poorly coordinated. Globally, it consists of the IMF and the World Bank. Regionally, it consists of regional financing mechanisms, such as the Chiang Mai Initiative Multilateralization (CMIM), and development banks, such as the Asian Development Bank. Bilaterally, it consists of currency swap lines between central banks and loans between finance ministries. Some countries self-insure by accumulating foreign exchange reserves, sometimes excessively, adding to global imbalances.

Research from the [IMF](#), [Bank of England](#) and [think tanks](#) finds that the safety net is adequate for small crises affecting individual economies, but inadequate for large crises that are more widespread. The safety net would [struggle to provide](#) the same level of support that has been

required of it at different times in the past. The biggest concern is the [composition of the safety net](#). The growth of regional and bilateral resources has increased the size of the safety net but has made it more fragmented. This problem undermines global stability and raises several challenges.

First, the size of the safety net depends on the country (Figure 2). Advanced economies and some major emerging economies are [well served](#) by the safety net. But many emerging and developing economies [fall through the cracks](#). They are at greater risk should they experience a crisis themselves or be swept-up as innocent bystanders during a global or regional crisis, fuelling spillovers into the U.S. and Australian economies.

Figure 1 Foreign currency debt and official reserves (2017, % of GDP)

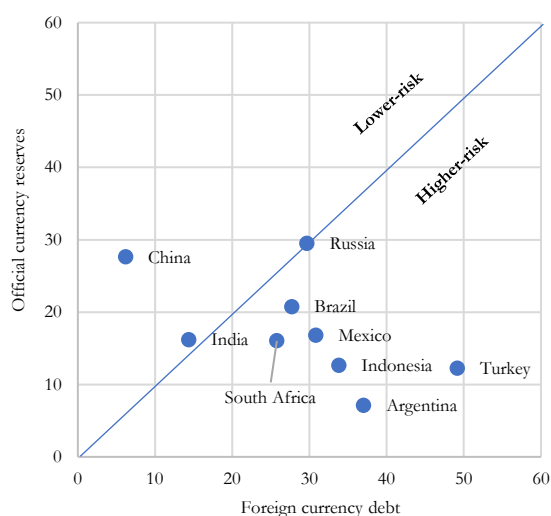
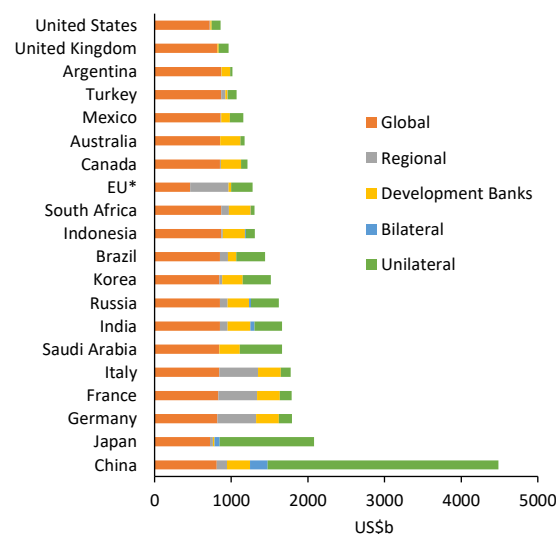


Figure 2 The size of the global financial safety net by G20 economy (USD)



Sources: [IMF \(2018\)](#) (Figure 1) and Triggs, 2018 (Figure 2)

Note: The global financial safety net, in Figure 2, includes global institutions,³ regional institutions,⁴ development banks,⁵ bilateral resources⁶ and unilateral resources.⁷

Second, limited cooperation between its different components has made the safety net's responses to crises [less consistent, less predictable and slower](#). This [makes crises costlier](#), both for the countries suffering the crisis and for the institutions and countries providing financial support. This limited cooperation relates to a [growing lack of clarity](#) around the purpose of the different components of the safety net, when they can be accessed and how they would work together in the event of a widespread shock.

Third, the safety net is relying on less efficient and more costly alternatives to the IMF. Asia's regional mechanisms are [untested](#), have a [narrower resource base](#), are [less experienced](#)

³ Global component: the IMF and World Bank

⁴ Regional component: the European Stability Mechanism, the Chiang Mai Initiative Multilateralization, the BRICS currency reserve pool, the Arab Monetary Fund, the Latin American Reserve Fund, the North America Framework Agreement and the EU Balance of Payments Facility.

⁵ Development Banks: Asian Development Bank, the Asian Infrastructure Investment Bank, the New Development Bank, the inter-American Development Bank, the Development Bank of Latin America, the African Development Bank, the Islamic Development Bank and the European Bank for Reconstruction and Development.

⁶ Bilateral component: currency swap lines that, according to in-depth interviews with G20 central bank governors, would be made available during a crisis (see [Triggs, 2018](#)).

⁷ Unilateral component: official foreign exchange reserves.

[with surveillance](#) and would [struggle to require countries to undertake necessary reforms](#). Bilateral swaps are [highly selective](#), opaque in which countries receive them, [raise moral hazard concerns](#) and are [less reliable](#) when crises affect multiple countries in the region. Issuing high-yielding local currency debt to sterilise foreign exchange reserves costs emerging economies [around 0.5 per cent of GDP each year](#). It distorts exchange rates, trade and investment flows and fuels global imbalances.

Finally, the fragmentation of the safety net is undermining the rules-based global order with unknown geopolitical consequences. In a process known as ‘[facility shopping](#)’, countries facing a crisis shop-around for financial assistance with the fewest conditions.

In sum, Asian financial systems are more resilient, but there is much more to be done to liberalise financial systems, deepen capital markets and open economies to trade in financial services. These challenges fuel global trade and current account imbalances and increase the frequency and severity of crises. The global financial safety net, however, is too small to deal with widespread shocks. Its fragmentation is creating increased systemic risks, increased negative spillovers, poor coverage, slower responses, higher costs, less consistency, less predictability and is undermining U.S.-led institutions. This is set to worsen. Bilateral loans to the IMF and its New Arrangements to Borrow [begin to expire in 2020 and 2022](#), respectively. Combined, these account for 50 per cent of the IMF’s resources.

U.S. and Australian Engagement

The U.S. veto in the IMF gives it the power to shape the next phase of IMF reform. Congress has historically been slow to reform the IMF based on concerns around its fiscal impact and concerns that it strategically weakens the U.S. Both concerns are misplaced. IMF resources are repaid, with interest, and it is the lack of IMF reform which is driving countries to create, and seek assistance from, non-U.S. led institutions.

The IMF serves [U.S. security and economic interests](#). In the long-term, the U.S. Administration and Congress should support substantive IMF reform in the G20 based around three key principles: the emerging markets taking on a larger role in crisis prevention consistent with their increased contribution to the global economy, preservation of the U.S. veto power, and increased permanent funding for the IMF through larger quotas, while preserving the current New Arrangements to Borrow. In the short-term, it should support IMF engagement and cooperation with regional mechanisms and be open to a Managing Director from a country other than Europe, provided other multilateral institutions follow-suit by opening-up management positions to other nationalities. The IMF should be led by an Asian Managing Director, perhaps with an American MD either before or after.

Australia, as a trusted and constructive substantive power, can play a useful role lobbying for IMF reform and greater cooperation between the IMF and regional mechanisms. But Australia’s greatest interest is financial stability in the region. Australia provided critical bilateral assistance during the Asian financial crisis and in the aftermath of the [global financial crisis](#), based on the legal framework for government-to-government financial support set out in the [International Monetary Arrangements Act](#) (IMAA Act). It should consider whether further changes to the IMAA Act are required to strengthen flexible and fast support to countries in the region, with adequate safeguards and governance in place.

While full membership should be pursued in the longer-term, Australia should deepen its engagement with CMIM and AMRO, perhaps starting with second-track dialogue. It should support the strengthening of their technical capacity, game-plan how Australian bilateral assistance could be deployed early with other bilateral and institutional support in the early stages of a crisis in South East Asia and help drive broader outreach with non-CMIM members. The Reserve Bank of Australia should increase its use of bilateral swaps in the region, ensuring clarity on when they would be made available and under what conditions.

Expanding trade in services in the Indo-Pacific will create substantial opportunities for U.S. and Australian firms by opening some of the largest financial markets in the world which, according to the OECD, are among the most restrictive. As these financial systems open, their citizens will demand services in areas where the United States and Australia have a comparative advantage, including banking, insurance, pension services and wealth management.

The Opportunity

Strengthening the financial systems and capital markets of Asian economies is an opportunity to get ahead of confidence-damaging crises, reduce their negative spillovers on the United States and Australia, reduce excessive trade imbalances and support market-access for U.S. and Australian firms.

The United States and Australia should support a new working group in the G20 on financial resilience to support prudent financial liberalisation in emerging market economies. Beginning with sharing information, technical assistance and staff secondments, the agenda's medium-term focus should be on phase-in programs to support efforts at gradual liberalisation. This could include opening specific financial services markets or asset classes to particular firms or countries to gradually increase competition and services trade. For advanced and emerging economies alike, policymakers could share information and experiences in strengthening the integrity of financial markets and boosting confidence in them by better protecting consumers and enforcing regulations.

Expanding trade in services will play a critical role. The United States and Australia should support a new G20 agenda on financial services trade. They should support a stronger focus on building financial infrastructure into regional initiatives that seek to improve connectivity — such as Belt and Road, the Asian Infrastructure Investment Bank and the Asian Development Bank including payment systems, credit information, collateral registries and financial institutions – on the basis of transparency and well-established high-quality standards around investment, procurement and the environment. The United States and Australia should ensure all countries sign onto, implement and advocate the use of APEC's Asia Region Funds Passport.

The integrity of financial markets and institutions matter. Australia's current experience with its Royal Commission – an independent and powerful review – into Misconduct in the Banking, Superannuation and Financial Services Industry shows just how far unprincipled greed and poorly implemented regulation in an otherwise stable system can lead to misconduct, undermine trust and destroy value for savers, borrowers and investors. The high-quality regulatory standards of the United States and Australia make them well-placed to

work together throughout region to raise quality of supervision and regulation, which would help build trust in financial markets and facilitate greater cross-border capital flows.

Strengthening the safety net presents opportunities, both outside and within a crisis. Outside a crisis, it is an opportunity to strengthen U.S.-led institutions and help engage the emerging economies constructively within that framework. It ensures the rest of the world is doing its fair share in supporting global financial stability. It helps ease excessive trade and current account imbalances by reducing the incentive to intervene in currency markets to accumulate excessive foreign exchange reserves. It encourages countries to reform and open their economies, boosting trade and investment, by providing a safety net that inspires confidence to open economies rather than incentives to close them.

Within a crisis, it is an opportunity to reduce negative spillovers on the rest of the world, reduce the burden on the United States and the resources of international institutions and reduce harm to communities by reducing the severity and duration of crises.⁸

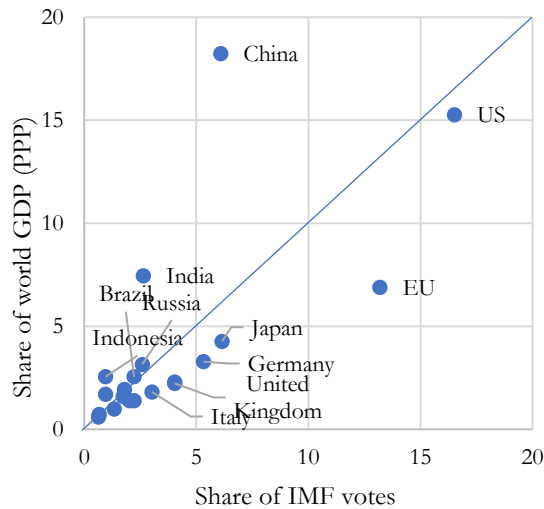
Strengthening the safety net means addressing the factors driving its fragmentation, many of which relate to perceived or actual deficiencies in the IMF which have incentivised countries to seek alternatives. These include insufficient IMF resources, the negative stigma and market response associated with going to the IMF, criticisms of the IMF's management of previous crises and an inability to substantially reform the IMF to make it more representative of the global economy and make its lending facilities more flexible.

A reformed IMF is at the core of a stronger safety net. Increasing IMF quotas and giving a larger share of them to the currently underweight emerging market economies will substantially increase the IMF's permanent funding and ease political tensions in the emerging markets while having them shoulder more of the burden. This can be achieved while preserving U.S. veto power. While the 2010 IMF reforms transferred 6 per cent of the IMF's voting power from the advanced economies to the emerging markets, many still have substantially fewer votes in the IMF than what their share of global GDP would imply. The extent of this shortfall depends on whether GDP is measured by purchasing power, market exchange rates or a combination of the two. Regardless of the measure, EU countries stand out as being overrepresented in the IMF and China as being underrepresented.

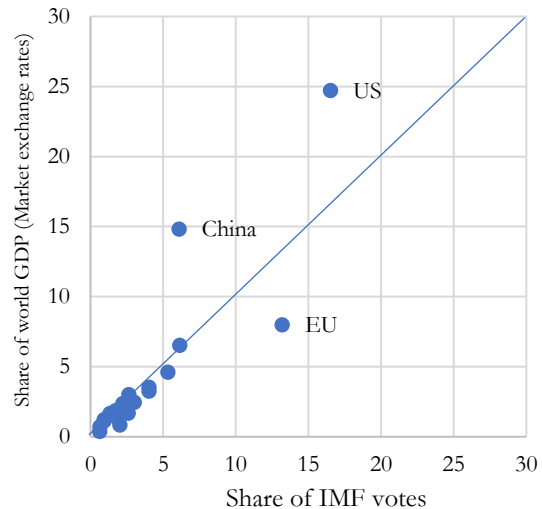
Increasing permanent IMF funding could allow more precautionary lending. Precautionary lending allows countries with strong fundamentals to be approved for IMF support before a crisis occurs. This helps reduce the stigma and negative market-responses associated with going to the IMF. The take-up of the IMF's existing facilities [has been small, constrained by insufficient IMF resources, lack of demand](#), and generally benign global market conditions until very recently. Increased precautionary lending by the IMF could include a review of whether the IMF could better leverage its balance sheet, making its precautionary facilities more akin to insurance than lending.

⁸ Much of the political and economic instability in Europe has been caused by a slow, inconsistent and insufficient response by the safety net to the European debt crisis. This is reminiscent of the Asian experience of the 1990s. Ten years since the global crisis, youth unemployment remains at 47 per cent in Greece. It is 39 per cent in Spain and 38 per cent in Italy. If unemployment continues to decline at its current rate, the unemployment rate in Greece will not reach today's OECD average until 2042.

IMF votes compared to share of global GDP (PPP) for G20 countries



IMF votes compared to share of global GDP (market exchange rates) for G20 countries



Source: Data from IMF, World Economic Outlook report, October 2018

But the need for IMF reform cannot be divorced from political realities. It remains a long-run objective. Increasing the IMF’s funding is politically challenging in [more than half](#) of G20 economies. Increasing the voting shares of the emerging market economies also implies a relative reduction in the shares of other economies, most likely from those currently over-represented (primarily EU countries and perhaps Japan) who would likely oppose the change.

Short-term measures to strengthen the safety net should, therefore, be prioritized. As a minimum, the IMF’s temporary funding should be maintained. The United States, Australia and other G20 countries should renew bilateral loans to the IMF and the New Arrangements to Borrow, noting that the United States does not currently provide a bilateral loan to the IMF. The G20 should improve the representation of the emerging markets in the short-term by freeing-up additional seats on its existing Executive Board for the emerging markets and appoint a non-European as the Managing Director of the IMF Christine Lagarde’s term expires in 2021.

Promoting better cooperation between the different components of the safety net ensures more stability in the short-term. The G20 could build on the principles it developed in 2011 as a starting point for this cooperation and develop formal guidelines on how the IMF would work with regional mechanisms during a crisis. Addressing the gaps identified in recent test-runs between the IMF and CMIM is the first priority.⁹

Better communication with the public on how the IMF works, how it is financed and how its members’ funds are used and repaid should also be a key objective. One of the [biggest political challenges](#) to contributing resources to the IMF is public opposition based on the perceived cost, as well as negative perceptions of the IMF. These cost-concerns are

⁹ Including inconsistencies between the time frames of the lending instruments of the different institutions, and the lack of a clear coordinating mechanism or structure See [Sterland, B. \(2017\)](#).

misplaced given country contributions to the IMF are repaid, with interest. The IMF's continued focus on reducing economic inequality could further improve its public image.¹⁰

A related near-term measure is to strengthen the capacity and readiness of regional mechanisms. In Asia, the CMIM members should focus on increasing the operational readiness of the mechanism and its market credibility, including through increased transparency of policies and procedures, and improving the technical capacity and surveillance activities of the ASEAN Macroeconomic Research Office. Australia should be actively involved in these discussions and seek membership of the CMIM over time as trust and relationships deepen. Where feasible, currency swap lines should be expanded and strengthened. The G20 should develop principles to ensure their transparent, consistent and cohesive use. On the fiscal side of these bilateral relationships, there is also scope for more countries to strengthen their legislative frameworks to allow fiscal authorities to have more flexibility in extending loans quickly.

¹⁰ Policymakers suggest report that there is a coalition of left-wing and right-wing entities in their political systems who oppose the IMF's role. For some in the left, the IMF is seen as an institution which oppresses developing countries and is a vehicle for an unpalatable form of conservatism, austerity and extreme capitalism. For some in the right, the IMF is seen as subverting democratic institutions and sovereignty. For the discussion with policymakers, see [Triggs A. \(2018\)](#).