THE ROLE OF ASIA AND THE PACIFIC IN GLOBAL GOVERNANCE AND MULTILATERALISM
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THE ROLE OF ASIA AND THE PACIFIC IN GLOBAL GOVERNANCE AND MULTILATERALISM
The Role of Asia and the Pacific in Global Governance and Multilateralism

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FOREWORD

The state of multilateralism today stands at a critical juncture. On the one hand, we have seen the phenomenal rise of Asia-Pacific over the last three decades as it reaped the gains of globalization underpinned by multilateralism. On the other hand, we see multilateralism coming increasingly under strain by various interest groups who perceive themselves as the losers of this system.

Asia Pacific has become a critical player in this system. It already commands over one-third of world GDP and world trade and its shares are growing. It is home to over half the world’s population. It is therefore critically important to understand the role that globalization has played in the region’s rise and how its contribution to shaping and transforming multilateral institutions has steadily evolved. In the age of the Sustainable Development Goals and Agenda 2030, the region’s challenge will be to lend support to the multilateral system and continue to maximise the benefits it offers while strengthening global institutions to enhance vigilance and be more effective in containing and managing attendant risks. The global governance system and multilateralism needs strong political will and urgent collective action to support its evolution toward greater inclusiveness.

This study is not a comprehensive overview of the role of Asia and the Pacific in globalization, global governance and multilateralism. Instead, it has selected a few aspects to focus on, namely trade, finance and climate change. Trade and finance are critical ingredients to the region’s success, yet it is increasingly coming under strain through climate change-induced impacts. From each of these emerges an expanding role of the region in the multilateral institutions that govern these areas, but also shows the crisis points that the global community must overcome.

Looking ahead, a more nuanced agenda for multilateralism will need to accommodate the much greater diversity of approaches and needs, without invalidating the overarching principles that guide the multilateral institutions, and address the accountability deficit, too.

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<th>Description</th>
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<tbody>
<tr>
<td>ADB</td>
<td>Asian Development Bank</td>
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<tr>
<td>AI</td>
<td>artificial intelligence</td>
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<tr>
<td>AIIB</td>
<td>Asian Infrastructure Investment Bank</td>
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<tr>
<td>ASEAN</td>
<td>Association of Southeast Asian Nations</td>
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<tr>
<td>BAU</td>
<td>business as usual</td>
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<td>BRI</td>
<td>China-led Belt and Road Initiative</td>
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<td>BRICS</td>
<td>Brazil, India, China, Russian Federation and South Africa</td>
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<tr>
<td>CBDR</td>
<td>common but differentiated responsibility</td>
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<td>CCl₄</td>
<td>carbon tetrachloride</td>
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<td>CDM</td>
<td>Clean Development Mechanism</td>
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<td>CFCs</td>
<td>Chlorofluorocarbons</td>
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<td>CMIM</td>
<td>Chiang Mai Initiative Multilateralization</td>
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<tr>
<td>CO₂</td>
<td>carbon dioxide</td>
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<td>COP15</td>
<td>15th Conference of the Parties</td>
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<td>CORSIA</td>
<td>Carbon Offsetting Scheme for International Aviation</td>
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<td>CPTPP</td>
<td>Comprehensive and Progressive Agreement for Trans-Pacific Partnership</td>
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<td>CSNs</td>
<td>countries with special needs</td>
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<tr>
<td>DSM</td>
<td>dispute settlement mechanism</td>
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<td>EEDI</td>
<td>Energy Efficiency Design Index</td>
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<td>ESCAP</td>
<td>Economic and Social Commission for Asia and the Pacific</td>
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<td>EU</td>
<td>European Union</td>
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<td>FDI</td>
<td>Foreign Direct Investment</td>
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<td>FTAs</td>
<td>free trade agreements</td>
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<tr>
<td>G20</td>
<td>The Group of Twenty Finance Ministers and Central Bank Governors</td>
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<tr>
<td>G77</td>
<td>The Group of Seventy-Seven</td>
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<tr>
<td>GATT</td>
<td>General Agreement on Tariffs and Trade</td>
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<td>GDP</td>
<td>gross domestic product</td>
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<td>GHG</td>
<td>greenhouse gas</td>
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<td>GVCs</td>
<td>global value chains</td>
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<td>HCFCs</td>
<td>Hydrochlorofluorocarbons</td>
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<td>HFCs</td>
<td>Hydrofluorocarbons</td>
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<tr>
<td>IBRD</td>
<td>International Bank for Reconstruction and Development</td>
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<td>ICAO</td>
<td>International Civil Aviation Organization</td>
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<td>ICT</td>
<td>information and communication technologies</td>
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<td>ILO</td>
<td>International Labour Organization</td>
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<td>IMF</td>
<td>International Monetary Fund</td>
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<td>IMO</td>
<td>International Maritime Organization</td>
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<td>IPCC</td>
<td>Intergovernmental Panel on Climate Change</td>
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The role of Asia and the Pacific in Global Governance and Multilateralism

IT information technology
ITA Information Technologies Agreement
ITMOs internationally transferable mitigation outcomes
ITO International Trade Organization
KP Kyoto Protocol
LDCs least developed countries
MARPOL International Convention for the Prevention of Pollution from Ships
MEA multilateral environmental agreement
MEF Major Economies Forum
MP Montreal Protocol
MRV measurement, reporting and verification
NAZCA Non-State Actor Zone for Climate Action
NDB New Development Bank
NDCs Nationally Determined Contributions
NSAs Non-state actors
NTMs non-tariff measures
OECD Organisation for Economic Co-operation and Development
PPP purchasing power parity
PTAs preferential trade agreements
QUAD Quadrilateral Security Dialogue
RCEP Regional Comprehensive Economic Partnership Agreement
SCO Shanghai Cooperation Organization
SIDS small island developing States
TFA Trade Facilitation Agreement
UNCTAD United Nations Conference on Trade and Development
UNDP United Nations Development Programme
UNEP United Nations Environment Programme
UNFCCC United Nations Framework Convention on Climate Change
WB World Bank
WIL World Inequality Lab
WTO World Trade Organization
EXECUTIVE SUMMARY

Since the second half of the 20th century, globalization -- supported by multilateral frameworks and institutions -- has facilitated economic growth and reduced poverty through increased trade and capital flows, and the exchange of technologies. Open and liberal policy frameworks across national frontiers have underpinned these benefits. Yet, while globalization has come with enormous gains, it has also created challenges for individual economies and transboundary risks. The system allowed ‘the few’ to appropriate most of these gains to increase their own wealth, and has worked against the shared prosperity of ‘the many’.

Globalization was supported by the creation of multilateral institutions¹ to coordinate actions and policies across a wide group of countries. Multilateralism arose from the understanding that globalization needed to be given a context of agreed rules to ensure its outcomes would be beneficial to all, and that it operated in an efficient and predictable manner.

Yet, multilateral rules and institutions have been undermined by a lack of global collective political leadership which has resulted in a failure to empower the principal multilateral bodies and made it difficult to hold them accountable. Multilateral organizations have been held hostage by inflexible process orientation and difficulties in reaching political consensus on key policy priorities in support of globalization. These challenges have stalled progress towards making global governance and regulation more effective. The consequent international regulatory deficit has provided vested interests with an opportunity to consolidate their advantage, magnifying in-country inequalities and excluding large segments of the population from benefiting from the gains of economic growth and development. Disruptions caused by frequent global, regional and national financial and economic crises triggered waves of public discontent across continents and undermined the prospects of globalization and multilateralism.

Notwithstanding these challenges, strategically positioned national economies have successfully pursued global and regional integration through trade, investment, capital flows, labour migration, and technology dispersion. Supported by capital accumulation and technology transfer, through national and cross border capital flows, countries have increased private and public investments and pursued economic growth paths that have reduced poverty.

Asia-Pacific economies have reaped substantial development gains from globalization and emerged as the world’s largest trading hub, accounting for 38 per cent of global exports and 35 per cent of global imports in 2016. This is in stark contrast to 1970, when the region’s shares stood at a mere 7 to 8 per cent. Indeed, the region’s rising per capita GDP has come with greater trade openness. Globalization placed Asia-Pacific at the heart of global value chains and supported a steady increase in foreign direct investment (FDI) flows into the region, especially to China and ASEAN countries. This is true even in the years that followed the 2008 global financial and economic crisis when global capital flows plummeted. Global trade and financial flows have helped lift millions out of poverty.

¹ The global Institutions underpinning globalization and multilateralism in the 20th century included the General Agreement on Tariffs and Trade (GATT), superseded by the World Trade Organization (WTO), the International Monetary Fund (IMF), the International Bank for Reconstruction and Development (IBRD), and the United Nations and its global agencies.
While a number of Asian economies achieved impressive economic success, their position within post-second world war multilateralism has gradually become discordant with their rising economic power and divergent needs. The global governance framework has not afforded Asian economies a voice commensurate with their economic influence, resulting in an accountability and trust deficit.

Moreover, the region faces challenges and risks from globalization that have surfaced over the years, including:

- Rising inequalities of incomes, wealth and opportunities within countries;
- Weaknesses in unfettered financial globalization and the global financial regulatory regime, which together have resulted in frequent episodes of global financial crises and contagion;
- An inadequate multilateral trading regime that struggles to address the new challenges arising from rapid technological advances and two-thirds of trade taking place through global value chains, as well as signs of noncompliance of certain states with the regime’s core principles and dispute resolution mechanism;
- A higher propensity of capital mobility relative to labour and resulting imbalances; and
- Climate change triggered by increased environmental stress and a rise in emissions.

Together the 2030 Agenda for Sustainable Development, the Addis Ababa Action Agenda on Financing for Development, and the Paris Agreement on Climate Change have heralded a new global compact. Focused on combatting poverty and inequality, this global agenda advocates resilience, inclusiveness and sustainability by ensuring policy consistency, coherence, and coordination to harness economic, social and environmental synergies in an increasingly interconnected world in order to promote shared prosperity. Among others, these global agreements promote global and regional cooperation to address gaps in the provision of transboundary public goods and issues surrounding climate, air quality, oceans, and disaster risks.

A backlash against globalization and a sense of corroding trust in the multilateral architecture and institutions pose a major risk to the implementation of the 2030 Agenda. Going forward, improving global governance through enhanced multilateral mechanisms is critical to achieving this holistic and ambitious agenda. This calls for renewed empowerment and addressing the accountability deficit in an effective manner. Although the current global economic recovery offers an opportunity to re-examine multilateral frameworks, the losses emanating from the 2008 global financial and economic crisis, the persistent and widely prevalent inequalities combined with a sense of unjust wealth accumulation have left deep scars and a loss of confidence in globalization among the advanced industrialized economies.

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1 It should be noted that not all Asian and Pacific economies shared in this success equally as it was concentrated on a smaller subset of East and South-East Asian economies, and not all of them sought to take up a larger responsibility at the global table.
2 Modern technologies and trade driven by global value chains requires trade rules that go beyond tariffs and border barriers. Thus, WTO rule-setting needs to turn towards discussing management of policies and measures which impact international coordination of production facilities, access to services and connectivity infrastructure, financing, risks, or managerial know-how.
What lends confidence to a forward-looking perspective is how leadership on globalization has moved from West to East, from the traditional ‘North’ to the ‘South’. Asia has not only stepped up its advocacy for globalization, but it is also strengthening global governance frameworks by seeking a greater voice and role, as well as by influencing a number of multilateral institutions to adapt. For example, revisiting the International Monetary Fund quota system to reflect the greater economic clout of Asian economies and including the Renminbi in the Special Drawing Rights basket are steps in the right direction, though institutional flexibility is still needed to adapt to further changing economic circumstances.

The establishment of the Shanghai Cooperation Organization (SCO) in 2002 serves to strengthen peace, security and stability and promote respect for territorial integrity across the Central Asia and South and West Asia belt. Most recently in the Astana Declaration, the SCO outlined steps that it will take to continue to combat threats to international peace and security which will in turn serve to promote sustainable economic development. Among others, these steps include: supporting the UN in its conflict resolution diplomacy and enhancing cooperation with the UN to counter challenges and threats; further development of the SCO Regional Anti-Terrorist Structure; adoption of the SCO Convention on Countering Extremism; and supporting measures to promote economic development as means to prevent the emergence of new sources of challenges and threats to security. Regarding the latter, the Agreement between SCO Member States on Creating Favourable Conditions for International Road Transport serves as an important practical step to establishing equitable conditions for managing mutually-beneficial trade flows from Eastern Europe to the Russian east coast and China. This Agreement has also served as a treaty-based foundation for multilateral comprehensive development of regional connectivity and market integration which will support sustainable development in SCO Member States. The ESCAP-SCO partnership further nurtures multilateralism by promoting cross border transport, energy and information and communications technology connectivity as well as market integration and disaster risk reduction.

Stronger regional economic cooperation and integration can be a stepping stone for strengthening the role of the Asia-Pacific region in globalization and multilateral trading and financial systems. On the trade and investment front, the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP) was negotiated by 11 economies (seven from the region) in 2017. Furthermore, 16 countries are negotiating the Regional Comprehensive Economic Partnership (RCEP), which includes commitments on, inter alia, investment, e-commerce, intellectual property, government procurement and standards. These agreements can help to uphold the multilateral trading system in spite of rising protectionist sentiment in many industrialized countries. Recognizing this, at the 2018 Japan-China-Republic of Korea Trilateral Summit, China encouraged both of its counterpart nations to fast track trilateral free trade agreement talks and urged RCEP to be pushed forward swiftly. As most parties to these agreements already have bilateral agreements, these mega-regional agreements also offer enormous potential to consolidate overlapping trade agreements and harmonize different policies, standards, approaches to rules of origin and other trade procedures, create greater transparency and

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*SCO members include the Republic of India, the Republic of Kazakhstan, the People’s Republic of China, the Kyrgyz Republic, the Islamic Republic of Pakistan, the Russian Federation, the Republic of Tajikistan, and the Republic of Uzbekistan. SCO observer states include the Islamic Republic of Afghanistan, the Republic of Belarus, the Islamic Republic of Iran and the Republic of Mongolia. SCO dialogue partners include the Republic of Azerbaijan, the Republic of Armenia, the Kingdom of Cambodia, the Federal Democratic Republic of Nepal, the Republic of Turkey, and the Democratic Socialist Republic of Sri Lanka.*
predictability, and reduce trade costs. However, to ensure that benefits from globalization are more widely spread, it is essential that the Asia-Pacific economies allow countries with special needs to avail of negotiated concessions on a non-reciprocal basis.

While comprehensive regional agreements that address economic, social and environmental trade and investment issues would certainly provide a useful basis for the development of better multilateral trade rules in support of sustainable development, the sub-regional or regional agreements on very specific trade and investment related issues (that is, sectoral in nature) may also provide useful inputs to further advance multilateral trade rule-making. A recent example of a region-wide initiative that can evolve into a multilateral platform is the Framework Agreement on Facilitation of Cross-border Paperless Trade in Asia and the Pacific. This UN treaty builds upon existing bilateral and subregional initiatives, such as the ASEAN Single Window Agreement, and supports the digital implementation of the WTO Agreement on Trade Facilitation (TFA) by providing an inclusive regional intergovernmental platform for developing and testing cross-border paperless trade solutions to achieve higher levels of trade facilitation and compliance.5

Asia-Pacific is likely to continue expanding its role in support of a new multilateralism, while concurrently deepening regional integration of trade, investment, labour and transfer of technology. The great contribution of the multilateral trading system over the past seven decades is a compelling argument for preserving both the system and the benefits it has brought. Moving ahead, we need a multilateral trading system that is built upon its successes, yet incorporates necessary reforms to represent the changing dynamics of globalization and the need to pursue sustainable development and shared prosperity for all.

While trade integration has progressed, albeit facing cyclical impacts, financial integration in Asia-Pacific has lagged behind. Developing domestic financial markets, and enhancing regional financial integration is critical to support the 2030 Agenda, but it needs to be pursued prudently and with safeguards. Long-term capital flows and foreign direct investment have positive effects, but large, short-term portfolio flows and lending carry risks that are difficult to mitigate. Financial crises, such as the one in East Asia in 1997, led to considerable loss of output, jobs and savings. Policymakers need to manage financial integration better.

Efforts to pursue multilateral financing frameworks must be stepped up to accelerate national infrastructure to eventually promote cross-border linkages. Besides augmenting the capital of institutions such as the World Bank and ADB, Asia has promoted new regional development banks such as the Asian Infrastructure Investment Bank. Added impetus will be provided by the China-led Belt and Road Initiative (BRI), a transformative plan which aims to develop transcontinental infrastructure connectivity across the Asia-Pacific region and beyond. The long-term vision of the BRI is broad, seeking to leverage transport, ICT and energy connectivity to enhance trade and market integration, as well as to deepen people-to-people contacts. By reaching 65 countries through land and sea connectivity, the BRI will link countries which together account for one-third of global output and 40 per cent of global trade. If properly guided by the principles of sustainable development, the BRI can help realise the 2030 Agenda.

5 Another example is the 1975 Convention on International Transport of Goods Under Cover of TIR Carnets (TIR Convention) initially aimed at facilitating transit among European economies. China, India and Pakistan recently acceded to the treaty.
in the countries it interlinks, through contributions to trade, infrastructure, job creation and inclusive growth. This impact may be most significant in the small developing landlocked economies where the BRI opens opportunities to participate in global value chains, upgrade infrastructure and widen access to reliable and sustainable energy sources. Moreover, the large investment requirements needed to realize this Initiative could incentivize the region to work together more closely to develop multilateral financing frameworks.

Enhancing multilateralism is also critical to combatting climate change. Asia and the Pacific is especially vulnerable to the effects of climate change, and rising emissions are translating into unliveable cities and rising morbidity and ill-health in the region. To this end, the Paris Agreement on Climate Change represents a breakthrough of multilateral efforts. Due to its universality, it has the potential to achieve its objectives, but success is by no means guaranteed. While a major strength of the Agreement is its broad participation, there is nonetheless a substantial gap between the Agreement's collective aims and the sum of the parties' individual Nationally Determined Contributions (NDCs). For the system to work, ambition and compliance need to be strengthened and supported through the provision of finance, technology and capacity building.

**Going Forward**

Given its size and growing economic and political clout, there is no doubt Asia and the Pacific will play a key role in the globalization of the 21st century. A key challenge confronting Asia and the Pacific's role in the future of multilateralism is the development of a clear and coordinated proposal to improve existing frameworks.

Going forward, Asia and Pacific is likely to increase its contributions to achieve more effective globalization and representative multilateral mechanisms. The region has the potential to play a greater role in setting global rules, taking the lead in ensuring an open and well-functioning economic system (such as trade and investment flows), continuing to step up its support to the developing countries (through enhanced connectivity, financial support or sharing regional knowledge), and taking greater responsibility of global economic issues (even if such action might temporarily undermine its economic performance).

Broad principles to move forward with globalization and strengthen multilateralism are two-fold:

First, diversity must be respected, both in terms of the prerogative of national governments in choosing the speed with which they may want to pursue globalization, and in their approaches in managing it and cooperating with each other, without invalidating the overarching principles that guide the multilateral institutions. A one-size-fit-all approach should be avoided.

Second, accountability must be strengthened by increasing the representation of developing and emerging economies in multilateral institutions.

In trade, many economies in the region especially the least developed countries, are still not part of the global production networks and still face high trade costs. Hence, the process of globalization needs to be made more inclusive. The multilateral trading system apt for the 2030 Agenda will be the one to support what are clearly different needs and
priorities as well as unequal implementation capacities of its members. As the WTO Director General, Roberto Azevêdo, put it, "in a rapidly changing world we need a trading system that is strong enough to help countries resolve disputes and flexible enough to help countries seize the opportunities that new technologies" and international fragmentation of production offer. The recent success of the WTO TFA, with its variable form of conditionality and flexibility regarding implementation modalities (as well as provision of technical assistance), provides a noteworthy example for the future direction of the multilateral trading system. Learning from the TFA, as well as from many of the bilateral and plurilateral trade agreements, Asia-Pacific economies should contribute to enhancing the WTO multilateral trading system by embracing more flexibility (that is, not trying to offer one-model-fits-all formulae) yet strongly footed agreements in the core principles of non-discrimination, transparency and predictability of rule enforcement. The new norm for multilateral trade diplomacy should be open plurilateral and sectoral agreements that are negotiated transparently inside the WTO and whenever possible lead to multilateralization of commitment benefits.7

Furthermore, given that an acute risk today appears to be arising from re-introducing damaging protectionist policies such as voluntary export restraints, orderly marketing arrangements, quotas and other instruments of managed trade, Asia-Pacific countries should prioritize:

- Defending the WTO’s dispute settlement mechanism by refusing unilateral retaliatory actions and instead building alliances with other WTO members and preserving the spirit of international cooperation (and not confrontation) which has underpinned the multilateral trading system for 70 years.

- Switching priority from negotiation of liberalization to rules-setting. This is especially important for smaller developing countries which typically have some resistance to embracing new issues or areas on the multilateral trade agenda. However, success of the TFA should encourage them to pro-actively seek new rule areas or new modalities for implementation which can lead to a reduction of their trade costs, improvement of competitiveness and increased benefits from trade.8

- Nurturing and strengthening regional and plurilateral institutions and agreements providing intergovernmental platforms for building consensus and reducing capacity gaps on trade-related matters among countries of the region, and fully utilize them as building blocks towards a more effective and relevant multilateral trading system.

While deliberating on future directions of financial globalization and a multilateral approach underpinning it, five insights should be kept in view:

- First, financial globalization should be regulated, including through prudent use of capital flow management measures which can help to regulate the flow of capital across borders. When used in conjunction with macro-prudential measures designed to limit systemic financial risks, these measures can help ensure

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8 Various services sectors, environmental goods and services agreements come to mind in this context.
domestic macroeconomic and financial stability. Moreover, it is important that a sound and effectively regulated domestic financial system precede regional or global financial integration.

- Second, balancing domestic policy priorities and politics against a more integrated and open global economy is a difficult task and a fundamental challenge in giving shape to the future of financial globalization and multilateralism.

- Third, institutions responsible for managing financial globalization should not promote or impose uniform economic ideologies and associated economic policies for all countries. These erode trust in multilateralism and raise doubts about the potential benefits of financial globalization.

- Fourth, a pluralistic approach, which acknowledges priorities of individual countries in terms of their preferred speed of integration and accommodates regional or sub-regional arrangements should be encouraged.

- Finally, innovative approaches to governing financial globalization and efforts to re-design multilateralism should respect and accommodate changes that have occurred in the world economy over the last 70 years, including the economic rise of Asia and the Pacific. This should facilitate the accountability aspect, and building trust in multilateral institutions.

Regarding climate change, the jury is still out on whether the multilateral approach through the Paris Agreement can succeed in achieving its stated aims. For the system to work, ambition and compliance need to be strengthened. In the context of a ‘pledge and review’ system, this means clear expectations that pledges will be regularly upgraded, and substantial transparency so that compliance with pledges can be monitored. For compliance it means countries acting to punish those that fail to make serious commitments or renege.

The record for climate change commitments without strong international enforcement – like the Paris Agreement – is not impressive (Bang et al, 2016). Pledge and review systems of this nature depend critically on transparency so that countries have a reputational stake in taking costly action on climate change and revising their ambitions upward. Yet critical transparency gaps remain that will only be filled through more multilateral-based work to clarify and harmonise the framework.

Increased climate ambition can also be supported through the provision of finance, technology and capacity-building. Moreover, ambition can be increased by widening the spectrum of actors from only states to other stakeholders, especially those that can have a potentially large impact on reducing emissions, such as cities, provinces, municipalities, and, very importantly, private sector entities.

It is also important to make a better economic case for the opportunities contained in the NDCs to both the business and donor communities through enhanced advocacy. While it is necessary to find a common metric to monitor collective progress towards requisite emissions reductions both by states and signatories of the Paris Agreement, this is equally important for non-state actors to create a connection between their reduction efforts and the NDCs to gauge progress towards the collective goal. A common metric is especially
important if the internationally transferable mitigation outcomes (ITMOs) foreseen by the Paris Agreement are to take off as a cost-efficient solution to achieving the NDCs.

ESCAP, as the regional arm of the United Nations in Asia and the Pacific, is well-positioned to support its member States in strengthening their role in global governance frameworks. Member States can leverage our intergovernmental platform to coordinate and develop proposals to enhance existing frameworks, which will encompass a broad set of state and non-state stakeholders. Our platform will also continue to serve as an important mechanism for finding multilateral solutions to the challenges our region faces. These solutions are critical to ensuring our region is able to effectively deliver on the 2030 Agenda for Sustainable Development.
I. INTRODUCTION

Since the second half of the 20th century, globalization has had a positive net impact. Through greater integration of national economies through trade, investment, capital flow, labour migration and technology, globalization has contributed to higher economic growth, wealth creation and poverty alleviation. However, this achievement has come at a cost.

Asia-Pacific economies have reaped substantial development gains from globalization. Over the past two decades, Asia-Pacific has grown to become the largest trading region in the world, accounting for 38 per cent of global exports and 35 per cent of imports in 2016, compared with a mere 7 to 8 per cent for import and export shares in 1970. The region’s rising per capita GDP has gone hand in hand with the greater trade openness, reflecting the expanding global value chains into Asia (known as Factory Asia), and a steady increase of FDI inflows especially to China and the Association of South-East Asian Nations (ASEAN). This has helped lift millions of people out of poverty.

Globalization was underpinned by the creation of multilateral institutions\(^9\) to coordinate actions and policies across a wide group of countries. Multilateralism arose from the understanding that globalization in its unbridled form needed to be given a context of agreed rules to ensure that its outcomes would be beneficial to all, and that it operated in an efficient and predictable manner.

Yet, several challenges and risks from globalization have surfaced over the years. These include, first and foremost, rising inequalities of incomes, wealth and opportunities within countries; the lack of an adequate international financial regulatory regime to cope with global financial crises and contagion; a multilateral regime ill-equipped to address the challenges of fragmented production and trade, and the erosion in labour’s relative bargaining power and consequent depressed wages from greater openness (which facilitated the mobility of capital relative to labour); and the exorbitant rise in greenhouse gas emissions that cause climate change.

Moreover, the global governance framework has not yet afforded Asian economies\(^10\) a voice commensurate with their economic influence, resulting in an accountability deficit.

The 2030 Agenda for Sustainable Development has heralded a new era for promoting shared prosperity and global development. It establishes that a holistic approach, capable of uniting economic, social and environmental aims in an increasingly interconnected world is required in order to achieve sustainable development. Vital issues such as the changing climate, air quality, oceanic pollution and disaster risks occur across boundaries and often can only be managed through multilateral co-operation.

These challenges have contributed, in part, to a backlash against globalization and a sense of corroding trust in the multilateral institutions. They suggest that a more inclusive

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\(^9\) The global institutions underpinning globalization and multilateralism in the 20th century included the General Agreement on Tariffs and Trade (GATT), superseded by the World Trade Organization (WTO), the International Monetary Fund (IMF), the International Bank for Reconstruction and Development (IBRD), and the United Nations and its global agencies.

\(^10\) Not all Asian and Pacific economies shared equally in this success as it was concentrated on a smaller subset of East and South-East Asian countries, and not all of them sought to take up a larger responsibility at the global table.
approach to multilateralism is needed – one that can address both the accountability deficit and allow national interests to be pursued.

The failure of policy, especially tax and spending policies, to redistribute the enormous gains from the small numbers of winners to the population at large has resulted in diminishing trust in globalization and multilateralism throughout the Western developed economies. By contrast, in the developing world, especially in Asia-Pacific, the attitude toward globalization has been relatively positive (Figure 1), largely because the public attribute the relatively higher growth and improved standards of living of the past two decades to globalization.

**Figure 1. Perceptions of globalization, selected economies, 2016**

![Figure 1: Perceptions of globalization, selected economies, 2016](image)


This report focuses on the benefits the Asia-Pacific region has derived from globalization, as well as the challenges and risks the region has faced, and how it has embraced multilateralism in three areas: trade and financial integration and climate change. These have been chosen as examples of where globalization and multilateral approaches are beneficial and should be pursued fully (trade), or with qualifications (finance), while the vexing issue of climate change must rely on multilateralism due to its scale and public good nature.

In the case of trade, the report argues that the case for globalization in Asia-Pacific is strong, because it has increased total wealth and well-being. While outsourcing manufacturing to lower-cost locations and advances in labour-replacing technological advancements have posed a threat to manufacturing jobs in developed and developing countries alike, on balance, the region has greatly benefited from producing and exporting goods more cheaply. Furthermore, Asia-Pacific countries have used plurilateral trade agreements to tread a path of more engaged regionalism, although these efforts need to employ the same principles as those that govern the international trade regime.11

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11 These include most-favoured nation status, national treatment, gradually freer trade through negotiation, predictability through binding and transparency, promoting fair competition and encouraging development and economic reform (see https://www.wto.org/english/thewto_e/whatis_e/tif_e/facts_e.htm). Baldwin (2016) distinguishes between an overreaching constitutional principle...
As labour-replacing technologies gain ground, policymakers in the region must build ambitious social safety nets that protect the inevitable losers.

By contrast, financial integration should be treated with more caution. Long-term capital flows and foreign direct investment have positive effects but large, short-term portfolio flows or “hot money” carry risks that are difficult to mitigate. Financial crises, such as the one in East Asia in the late 1990s, have been highly detrimental and led to losses of jobs and savings. Policymakers must do a better job of managing financial integration. There have been attempts to adapt the multilateral institutions. For example, a revisit of the IMF quota system to reflect the greater economic clout of Asian economies is a step in the right direction, although further changes are needed. As with trade, the region has turned to alternatives such as creating new regional development banks and funds and launching regional initiatives for financial cooperation.

Regarding climate change, the early multilateral architecture struggled to accommodate the changing context of Asia-Pacific’s economic rise over the past two decades, which fundamentally altered roles and responsibilities for tackling the problem. After a hiatus, multilateral negotiations culminated in the Paris Agreement, which entered into force on 4 November 2016. Due to its universality, it has the potential to achieve its objectives, but success is by no means guaranteed. The region is vulnerable to climate-change impacts, which are already being felt. Rising emissions are translating into unliveable cities, rising morbidity and health costs. These are ample incentives for the region to make a significant contribution to a more ambitious multilateralism.

This remainder of this report is divided into three parts. Part II provides an overview of the benefits of globalization from the perspective of the Asia-Pacific region and cutting across various aspects such trade, migration, finance and human development; as well as the challenges and risks to globalization, especially in-country inequality, financial contagion, rising greenhouse gas emissions and those linked to migration flows. In Part III, the changing role of multilateralism is explored through the lens of trade, finance and climate change. Part IV offers a forward-looking perspective in each of the three areas discussed in Part III.

that the world trade system be rules-based and five specific principles, including non-discrimination, transparency, reciprocity, flexibility and consensus decision-making.
II. BENEFITS AND COSTS OF GLOBALIZATION

A. Benefits of globalization

Globalization encompasses international integration of trade, capital and labour flows (Bordo et al., 2003) and the accelerating role of global value chains (GVCs), fueled by the expanding digital economy and the services sector. The increasing size of international trade relative to world output is an indicator of globalization over time. By the eve of the global financial and economic crisis in 2008, trade accounted for around 60 per cent of world GDP (Figure 2).

Figure 2. Global trade as a percentage of world GDP, 1500-2016

Source: ESCAP’s compilation based on data from World Bank’s WDI database and ourworldindata.org (CC BY-SA license), retrieved through Esteban Ortiz-Ospina and Max Roser (2018).

1. Trade expansion led to rapid economic growth and considerable development opportunities

As the world saw the gradual erosion of barriers to the free flow of goods, services and capital among countries, globalization increasingly provided access to markets, advanced technologies and financial resources, which enabled the developing economies to grow and prosper.

Developing Asia-Pacific countries are an outstanding example of the great benefits that can be derived from globalization. Developing Asia-Pacific economies increasingly liberalized their trade regimes on a multilateral, unilateral and plurilateral basis. By 2017, two-thirds of ESCAP’s membership had joined the World Trade Organization (WTO); many implemented unilateral reforms to open their economies and two-thirds of globally enforced free-trade agreements (FTAs) involved members from Asia-Pacific. Effective tariff protection in the region dropped from 19 per cent in 1988 to 6 per cent in 2016. Amid rising participation in global trade, the region saw rising national income, shrinking

12 United Nations (2017), Fulfilling the promise of globalization: advancing sustainable development in an interconnected world, Report by the Secretary-General, A/72/301 defines globalization as “the growing integration of trade and financial markets, the spread of technological advancements, the receding geographical constraints on social, cultural and migratory movements and the increased dissemination of ideas and technologies”.

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absolute poverty, flourishing innovation, higher wellbeing and life expectancy, and better education.

Trade expansion has been a sustained growth engine for the developing Asia-Pacific region for nearly three decades. On average, developing Asia-Pacific GDP and exports grew annually at nearly 6 per cent and 13 per cent, respectively, from 1990 to 2008.13

The region has become a large trading dynamo. Trade increased from 33 per cent of regional GDP in 1990 to more than 50.4 per cent in 2016 (figure 3).14 Asia-Pacific economies have collectively grown from a mere 7-8 per cent of global trade in the 1970s to become the largest trading region accounting for 38 per cent of global exports and 34 per cent of global imports in 2016.

Figure 3. Openness and share of global trade and GDP, Asia-Pacific (1990-2016)

2. Regional and global value chains proliferated, driven by lower trade costs

Over the past three decades, globalization morphed from the internationalization of trade to the internationalization of production. For most of the 20th century, trade involved cross-border flows of finished goods. From the 1990s, it transformed into flows of intermediate products, ideas and know-how. According to UNCTAD (2013), “about 60 per cent of global trade, which today amounts to more than $22 trillion, consists of trade in intermediate goods and services that are incorporated at various stages in the production process of goods and services for final consumption.”15

The proliferation of GVCs has been driven by a decrease in international trade costs as a result of revolutions in ICT and transport technologies, as well as by trade liberalization and regulatory reforms. Both technological and policy factors have made it possible and

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13 During 2000-2008 this growth was even more impressive with GDP accelerating at 7.5% and exports by 16% per year.
14 Before the 2008 global financial and economic crisis, trade accounted more than 60 per cent of the region’s GDP. However, dependence on trade has declined to about 52 per cent of GDP as a result of the slowdown in global demand and repositioning of the growth strategy for many countries towards domestic consumption.
optimal for manufacturers – especially in apparel and textiles, automotive and electronics – to unbundle their value chains and form geographically dispersed value chains at the global and regional level.\textsuperscript{16}

A greater division of labour and segmentation of production on a global scale in GVCs allows more economies to benefit from trade. Evidence shows that GVC-driven trade has brought investments in new productive capacity and massive infrastructure improvements in developing economies, boosted employment, enabled larger-scale production, driven more efficient geographical allocation of industrial activities, and increased the availability of a variety of intermediate goods.\textsuperscript{17}

Developing Asia-Pacific economies, especially in East and North-East Asia and South-East Asia, are an example that the integration with GVCs can fast-track industrial development in developing countries. More than 43 per cent of global GVC-intermediate exports came from the Asia-Pacific region. GVC exports by Asia and the Pacific are dominated by electronics parts and components from developing economies in East and North-East Asia and South-East Asia. However, it is important to note that although GVCs in principle should promote economies of different development levels to jointly take part in the production process, it appears that Asia-Pacific participants in GVCs are mostly in the high- and middle-income categories while low-income economies are being left out. In general, 90 per cent of these trade flows are concentrated in just 10 countries, i.e., Australia, China, Japan, India, Indonesia, Malaysia, the Republic of Korea, Singapore, Thailand, and Turkey (ESCAP, 2015).

3. Outward-orientation triggered structural economic transformation

Globalization and outward-orientation has stimulated the process of structural transformation in the region. Manufacturing, which comprises 60 per cent of merchandise exports of developing Asia-Pacific, has increased its technological complexity. Shares of high tech exports increased from 6 per cent in 1988 to 32 per cent in 2000 (figure 4). Asia-Pacific became a dominant exporter of information technologies products, raising its global export share from 10 per cent in 1996 to 61 per cent in 2015. This success resulted from the region’s participation in the GVCs of such products following their trade liberalization by the 1996 WTO Information Technologies Agreement (ITA). The ITA has allowed economies in the region to access high-quality technology products which were key for developing digital infrastructure at a lower cost and set the stage for the Fourth Industrial Revolution.

Services have become an important element of Asia-Pacific economic development. The internationalization of production has intensified the reliance on services to improve ‘just-in-time’ delivery, cost efficiency, brand loyalty, and quick adjustment in response to short product life-cycles. The contribution of services to GDP increased from 55 to 59 per cent from 2005 to 2016. The services sector made up over half of total exports by value added (ESCAP, 2017). From 2005 to 2016, the Asia-Pacific region was the only region whose shares in the global exports of commercial services increased steadily from 20 per cent to 26.5 per cent, in particular, financial, travel and ICT services.


\textsuperscript{17} See chapter 7 of ESCAP (2015) for more details.
4. Increased access to technology and innovation

Globalization has augmented access to technology and information. One common way in which globalization can bring technology transfer and upgrading is through foreign direct investment (FDI). When a firm receives FDI, it develops a close relationship with the investor, typically a larger firm, and maybe even a lead firm in a GVC. Technology transfer through FDI relies on the investor having access to globally competitive technologies that it can make available to a developing country partner. Hence, interactions between foreign affiliates and domestic firms in host countries increase the potential of knowledge and technological spillovers to domestic firms including SMEs.\(^{18}\)

Cases studies in developing Asia-Pacific show that FDI has played an important role in transferring technology. For example, FDI boosted technology upgrading in China’s photovoltaic cell sector (ESCAP, 2015). In Thailand, studies find that a greater presence of foreign subsidiaries is positively associated with research and development activities (Saliola and Zanfei, 2007). In addition, it is also possible to gain access to technology through importing appropriate capital and intermediate goods. Machinery and equipment often embody modern technology; this implies a channel of technology transfer from more advanced to less advanced countries.

In the 21st century, the pace of transfer of technology, ideas, information, business collaboration and social connections are going to increase tremendously. The global connectedness index shows cross-border flows of information grew by more than 60 per cent between 2005 and 2015, while trade and capital flows grew at a much slower pace (figure 5). During this period, the amount of cross-border internet bandwidth used

\(^{18}\) See chapter 9 of ESCAP (2015) for more details.
increased by 45 times (MGI, 2014). Interconnectedness will continue to accelerate through better technology that will improve efficiency and bring costs down further. Frontier technology such as quantum computing, telerobotics, remoted-artificial intelligence (AI), and 3D printing are increasingly virtualizing the flows of goods, services and globalization and will continue to transform physical flows into virtual flows and deepen the interconnectedness among economies. Hence, the ability to move data will become a critical factor determining the flows of goods, services, capital and people.

**Figure 5. Global flows of capital, information, people and trade (2005-2015)**

![Graph showing global flows of capital, information, people and trade from 2005 to 2015.](source)

*Source: DHL global connectedness index 2016.*

*Note: The index measures the global average of the size of countries’ cross-border flows compared with a relevant measure of the size of their domestic economy. Capital flows include FDI and portfolio equity. Information flows are measured by international internet bandwidth, minutes of international telephone calls and trade in printed publications. People flows include migrants, international tourists, and international students. Trade flows include merchandise and commercial services trade. For further methodological details, see DHL (2016).*

5. **Globalization has favoured adoption of international norms and standards**

Globalization potentially enhances a developing country’s access to norms and standards enabling trade expansion and contributing to safer domestic consumption. Exposure to international markets can increase international attention on domestic production standards and cause domestic firms to improve their standards to enhance access to international markets. For example, private voluntary initiatives allow consumers and investors to express their values relating to working conditions. Provisions in trade agreements can be an external force for an improvement in labour standards in developing countries. Globalization can helped to spread the positive effects of environmentally-friendly technologies and practices.

In the Asia-Pacific region, it appears that there is a positive correlation between labour standards and globalization. Empirical evidence shows that labour in the FDI-intensive/export industries in Cambodia and Indonesia have generally better wages and non-wage working conditions than much of the rest of the local economy (World Bank, 2008). Generally, labour markets in export-oriented sectors which attract FDI are characterized as decent jobs with high wages and better non-wage working conditions. In contrast, agriculture, offers jobs with low wages and poor non-wage working conditions.
6. **International migration brings large remittances to countries of origin**

International migration is also becoming a prominent feature of globalization in the Asia-Pacific region. The number of international migrants in the Asia-Pacific region increased by over 20 per cent between 1990 and 2017, rising from 51.6 million to 62.2 million.\(^{19}\) Much migration takes place within the Asia-Pacific region: of the 62 million migrants in the Asia-Pacific region in 2017, 44.3 million were from other countries in the region. Migration is extremely concentrated within specific sub-regions. In North and Central Asia, for example, 11.5 million of the 17.6 million migrants originate in the same sub-region.

International migration in Asia and the Pacific is predominantly driven by economic factors, especially where demand for labour, or specific skills, grows in countries of destination which can offer relatively higher wages. According to ILO estimates, in 2013, of a total of 44.5 million migrants over the age of 15 in Asian and Pacific countries (excluding the Russian Federation), 32.8 million were migrant workers.\(^{20}\) The large-scale migration of people from Asia-Pacific to the oil-producing countries of the Gulf Cooperation Council, which host a further 20.9 million Asian and Pacific migrants, is driven by similar factors.

Evidence consistently suggests that migrants bring several beneficial effects to destination economies. Migrant workers are typically engaged in work that is either highly-skilled, bringing additional capacities to countries of destination, or in low-skilled occupations which are unappealing to local residents for reasons of pay or status. As such, they complement native workers and contribute to economic growth and output. For example, international migrants are estimated to have contributed up to 6 per cent of Thai GDP in 2013.\(^{21}\)

Benefits for countries of origin are often expressed in terms of the remittances sent by migrant workers. The countries of the Asia-Pacific region received almost $276 billion in 2017. While the largest amounts went to India and China ($65 billion and $62 billion respectively), the largest impacts are often felt in least-developed or landlocked developing countries, or small island developing states, where remittances make up a significant proportion of GDP, such as Nepal (32 per cent of GDP in 2015), Tajikistan (29 per cent), Kyrgyzstan (25 per cent) and Samoa (20 per cent).\(^{22}\) These remittances have a significant impact on families and communities – for example they reduced the number of people living in poverty in Kyrgyzstan by an estimated 6 to 7 percentage points per year in 2010-2013.\(^{23}\) In addition, remittances can help stabilise balance of payments deficits, can stimulate financial-sector development and can be mobilised, in collaboration with migrants and local communities to provide a source of financing for infrastructure.

7. **Capital mobility enhanced access to finance**

Financial globalization facilitates the free flow of capital into and out of a domestic economy and high foreign participation in the domestic financial system. If managed well, it can yield considerable benefits for the economy. Capital mobility across borders can

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\(^{22}\) World Bank staff calculation, based on data from IMF Balance of Payments Statistics database and data releases from central banks, national statistical agencies, and World Bank country desks.

\(^{23}\) UNDP 2015, Labour Migration, Remittances and Human Development in Central Asia.
enhance access to financing for domestic investments, and thus raise economic growth. Similarly, foreign financial institutions can facilitate credit intermediation and maturity and risk transformation across national borders, along with promoting competition, innovation and adoption of new technologies. In addition to these direct effects, financial integration contributes to the development of the domestic financial sector and to better governance.

Global cross-border capital flows, a widely used proxy for financial globalization, increased consistently during the 1990s and the early 2000s, and reached a peak of $12.4 trillion in 2007 on the eve of the United States-led global financial and economic crisis of 2007-2008. After the crisis, they plunged to about $2-3 trillion a year in 2008 and 2009 (figure 6). Although these flows recovered after 2010, they remain well below pre-crisis levels. The value of global flows in 2016 stood at $4.3 trillion; only a third of the 2007 peak value. The decline is even more notable in reference to global GDP, dropping from around 21 per cent in 2007 to below 3 per cent in 2016. Relative to the size of global GDP, the shares of most major types of capital flows, including foreign direct investment, portfolio investment and cross-border lending, have decreased since 2008. McKinsey (2017) estimates that around half of the decline in global capital flows is driven by a sharp contraction in cross-border interbank lending.

Whether the current level of flows is “appropriate”—that is, channeling savings to productive investment while promoting financial stability—is unclear. Mallaby (2016) notes that financial globalization between 2004 and 2007 may have overshot. The average level of global financial flows of about 5 per cent of global GDP in 2011-15, can be characterized as broadly consistent with stable global economic expansion.

Figure 6. Global cross-border capital flows, 1990-2016

![Graph showing global cross-border capital flows, 1990-2016](Source: McKinsey (2017)).

Cross-border capital flows to Asia-Pacific have generally been more buoyant than the global trend in the post-crisis years. Similar to the global trend, capital inflows to developing Asia-Pacific economies declined sharply after the global economic turmoil; from $1.7 trillion in 2007 to about $400 billion a year in 2008 and 2009 (figure 7). However, unlike the global trend, capital inflows rebounded strongly afterwards, reaching an annual average of $1.4 trillion in 2010-2014. Various interconnected factors explain the revival of capital flows into the region, including (a) abundant global financial liquidity amid sizeable monetary injections in developed economies, (b) unusually low interest rates in developed markets that prompted global investors to search for higher returns, and (c) stronger and more stable economic growth prospects in Asia-Pacific.

The recovery of financial flows into the Asia-Pacific region was underpinned mainly by portfolio investment, especially purchases of debt instruments, and cross-border interbank lending (figure 8). In value terms, cross-border bank lending increased, notably in China and Hong Kong, China, while lending as a share of GDP also rose in economies such as India and Malaysia. One emerging trend is that banks in the region have increased their intraregional interbank lending in recent years, particularly for banks based in Hong Kong, China; Republic of Korea; and Taiwan Province of China (James et al., 2014). According to the Asian Development Bank (ADB) (2017), the value of intraregional cross-border interbank lending accounted for 22 per cent of total stock of cross-border financial asset holding by developing Asia-Pacific economies in 2015. This share increased from 16 per cent in 2010.

Other components are foreign direct investment (39 per cent share), equity investment (20 per cent share) and portfolio investment in debt instruments (17 per cent share).
8. Human development improved while poverty declined

The Human Development Index increased steadily for the entire region over the recent decades; and for East Asia and the Pacific it surpassed the global average in 2014 (figure 9).

Figure 9. Human development index values, 1990-2015

The proportion of people living in extreme poverty decreased drastically (figure 10). Nearly half of the Asia-Pacific population was earning less than $1.90 a day, on average, in 1990, but by 2015 this level had fallen to less than 12 per cent.

In addition, aggregate living standards improved. Life expectancy rose from 69 years to 75 years during the same period, and the mortality rate from all major causes of death fell by 15 per cent. More than 70 per cent of Asia-Pacific countries have higher literacy rates than the world average.
Figure 10. Poverty headcount ratio at $1.90 a day (2011 PPP, percentage of population)

Source: World Bank, World Development Indicators database.
Note: Aggregates weighted using respective year population data from the World Bank.

Figure 11 shows the distribution of people by daily income per capita (in international dollars, 2011 constant prices and adjusted by PPP) across world regions. From the 1960s to the 1980s, the two-humped distributions illustrate a clear divide between the rich regions, dominated by economies in Europe and North America, and the poor regions covering most of Asia-Pacific region and Africa. Over the following three decades, the income distributions of world regions converged into a one-humped distribution driven by the rising incomes of developing Asia-Pacific populations.

Figure 11. Distribution of world populations by daily income per capita (in international dollars, 2011 constant prices, and adjusted by PPP) by region (1965, 1986 and 2015)

Source: Based on free material from GAPMINDER.ORG, CC-BY LICENSE. Accessed March 2018.
The Asia and the Pacific region’s integration with the global economy resulted in decreasing inequalities among its countries, as shown in Figure 12.

The 2015 Lorenz curve shows a significantly more egalitarian distribution of gross national income than the curves for 2005 and 1995, reflecting a drop in the Gini coefficient, from 76.9 in 1995 to 49.2 by 2015 (ESCAP, 2018). This mainly reflects the rise in gross national income of China, from under $600 in 1995 to close to $8,000 in 2015.

Figure 12. Lorenz curves for gross national income per capita in Asia and the Pacific, 1995, 2005 and 2015

Note: The figure includes all countries.

B. Costs of globalization

For all its benefits, globalization has also brought about challenges and risks, such as the rise in inequality within countries, the risk of trade wars, higher financial volatility and instability and financial contagion across countries, higher greenhouse gas emissions which cause climate change and challenges of integrating migrants. For example, globalization and technological advancements tend to favour skilled over unskilled labour, and hence act as a factor that widens wage inequalities. Indeed, countries in the region have observed surging in-country income and wealth inequalities, which have reinforced existing inequalities of opportunities. Such challenges and risks have resulted in changing public perceptions about the merits of globalization.

1. Inequality within countries increased

Not all countries and regions benefitted equally from globalization. In the Asia-Pacific region, countries with special needs (CSNs), especially least developed countries (LDCs), small island developing States (SIDS) and the countries in the South and South-West, Poverty data of Pacific subregion economies have availability issue. Therefore, the data is an estimation, which may deviate from the real situation.
and North and Central Asian sub-regions, experienced a slower pace of extreme poverty reduction than the rest of the region. In fact, as a percentage of their total populations, poverty was stagnant for these country groupings from 2010 onwards (figure 13).

**Figure 13. Poverty incidence (percentage of population earning less than $1.90 per day), Asia-Pacific subregions**

Moreover, income inequality increased significantly within many developing countries. Three-quarters of the region’s population live in countries where inequality has risen over the past three decades (figure 14). On average, measured by the population-weighted market income Gini coefficient, the region’s inequality increased by close to five percentage points during this period; from 33.5 in 1990-1994 to 38.4 in 2010-2014. This is driven by rising within-country inequality in the region’s most populous countries, such as Bangladesh, China, India and Indonesia.

Yet, the evidence that globalization (seen as trade and FDI openness) contributed to the rising inequality is mixed. At the global level, the “elephant curve” of global inequality and growth in figure 15 shows that high economic growth during the past two decades benefited both the poor in developing regions (the world populations in the bottom 50th-percentile of income) and the very rich (world populations in the 1st-percentile), but not the global middle class (which contains the majority in the European Union and the United States). Other factors may explain rising inequality during those periods, including capital accumulation, technological growth, structural transformation from agriculture to manufacturing sectors, educational inequality and a decline of tax progressivity (WIL, 2018; and ESCAP, 2018b).
Figure 14. Changes in income inequality by country, 1990 and 2014

Source: ESCAP (2018b).

Note: Labels next to each bar show each country’s average market income Gini coefficient in 2010-14. The Gini coefficient of each country was calculated as the simple average of the available Gini coefficients within each 5-year period (1990-94 and 2010-14).

Figure 15. The elephant curve of global inequality and growth (1980-2016)

2. Increased exposure to external shocks and financial crisis

The increased connectivity brought about by GVCs has made economies more interdependent and increased the likelihood that a local disruption will lead to a system-wide failure. There have been several examples in the present decade that national crises could spread and amplify in the hyperconnected world. The just-in-time nature of many GVCs causes a demand shock in final goods in one country to be transmitted almost instantly to suppliers of intermediates in other countries. For example, the disruptive impacts of natural disasters can also rapidly spread in GVCs, as was demonstrated in 2011 following the Tohoku earthquake and tsunami in Japan and later following flooding in Thailand.

International trade is an important means of transmitting international shocks. As occurred during the 2008-09 recession, international trade fell five times more than global GDP.

The dramatic increase in cross-border capital flows as a result of rapid financial globalization in the past few decades, along with associated volatility in such flows, calls for a careful examination of their potential costs, particularly for developing countries. There is broad consensus that excessive financial globalization contributes to financial crises, or at least their proliferation and transmission to other countries.

Kose et al. (2007) point to the debate among economists who see the increasing volume of capital flow as disruptive to financial stability globally and thus advocate capital controls of some sort. In the context of developing countries, this poses a question as to how soon and to what extent they should remove national restrictions on capital flows, while integrating with the global economy.

However, Kose et al. (2007) also point to the difficulty in accurately measuring financial openness and thus the challenge of estimating the effects of financial globalization. The upshot of their analysis is that any assumption regarding the causality and correlation between financial liberalization and financial integration and socio-economic development and financial stability should be treated with caution. Neither the link between financial globalization and governance and macroeconomic policies seem clearly established. As the data often provides little evidence of any relation, it is important to learn and to understand “the specific channels through which different types of inflows affect growth dynamics” (Kose et al. 2009, p. 50), as well as the indirect consequences of financial globalization such as productivity growth and macroeconomic stability.

A consensus view is that “moderate” financial globalization, if adequately managed, may bring extensive benefits to all countries, including developing countries. While access to capital is critical in the context of financing for development, developing countries that intend to increase their financial integration with the global economy need to follow a “gradualist approach”. Often, a low level of development is accompanied by weak institutions and regulations, ineffective economic policies and governance weaknesses. A “shock therapy”-style fully-fledged opening of the capital account can make such countries vulnerable external shocks and sudden stops of capital flows. Therefore, developing countries need to establish efficient regulatory regimes first and follow stabilizing macroeconomic policies, which will allow for erecting strong financial institutions and for developing the financial sector as a whole. This more cautious
approach is also reflected in the IMF’s revised approach to capital-account liberalization, which does not rule out the use of credit-flow measures if capital flows pose risks to the stability of the macroeconomy or the financial system (IMF, 2015).

Indeed, one of the lessons learnt in the Asian financial crisis is that domestic financial reforms should precede financial globalization. Financial globalization can contribute to domestic financial development (as a catalyst of “collateral benefits”), but it is neither a sufficient nor necessary condition. Certain prerequisites or initial conditions, taking into account individual country circumstances, have to be met before a country can be expected to benefit from financial globalization. Otherwise, the benefits can be delayed and the country can be more vulnerable to sudden stops of capital flows. A phased and sequenced domestic financial liberalization and financial deepening, supported by appropriate financial stability safeguards, can help achieve most of the benefits of financial globalization while minimizing risks of excessive volatility, contagion from abroad and crisis.

3. Emissions that cause climate change grew dramatically

Globalization and the embodied increase in the mobility of the factors of production have hastened the increase in greenhouse gas (GHG) emissions which cause global warming. Transmission channels include the growth in trade and manufacturing, and urbanisation rates, which have resulted in higher carbon emissions from increased production, transport, residential energy consumption, or land-use changes, through changing patterns in production and consumption. Over the past few decades, greenhouse gas emissions (GHGs) rose as the Asia-Pacific region developed into the world’s low-wage manufacturing hub, led by China.

Figure 16. Carbon dioxide emissions, Asia-Pacific countries (million Gg CO2 per year)

Source: EDGAR JRC.
Although carbon dioxide (CO\(_2\)) emissions in the region have been steadily increasing over the period, they got a big lift after 2001, when China entered the World Trade Organization (WTO) and rose to dominate global exports (figure 16).

Globalization and the embodied increase in the mobility of the factors of production have hastened the increase in greenhouse gas (GHG) emissions which cause global warming. Transmission channels include the growth in trade and manufacturing, and urbanisation rates, which have resulted in higher carbon emissions from increased production, transport, residential energy consumption, or land-use changes, through changing patterns in production and consumption. Over the past few decades, greenhouse gas emissions (GHGs) rose as the Asia-Pacific region developed into the world’s low-wage manufacturing hub, led by China.

Emissions in the region increased from 28 per cent of global emissions in 1970 to 58 per cent by 2015 as the share of the region’s manufacturing went from 22 per cent to 50 per cent over the same period.\(^{27}\) Average annual emissions in the region grew by 1.7 per cent in the 1990s, but then accelerated to 4.5 per cent in 2000-15 (figure 17).

**Figure 17. Asia-Pacific and global CO\(_2\) emissions, 1990-2015**

![Graph showing CO\(_2\) emissions](Source: Olivier et al. (2016)).

Globalization has led to greater urbanisation rates in the Asia-Pacific region, which in turn, contributed to rising GHG emissions as rural populations adopted internal migration to cities as a strategy to improve their livelihoods and benefit from better services in urban areas. Between 1990 and 2015, around one billion people migrated from rural to urban areas in East and South Asia and the Pacific, pushing up the urbanisation rate from 34 per cent to 57 per cent in East Asia and the Pacific and from 25 to 33 per cent in South Asia over the same period.\(^{28}\)

\(^{27}\) As measured by global CO\(_2\) emissions from fossil fuel use and cement production 1990-2015.

\(^{28}\) Data from World Bank, World Development Indicators, http://wdi.worldbank.org/table\(5.12\).
Urbanisation has negative implications on emissions: urban areas are the focal point of economic development, industrial activities, urban sprawl, land-use changes and automobile transportation. This leads to the construction of more businesses and infrastructure, increasing overall transportation needs and energy use. Urban industrial activities have also been shown to play a significant role in GHG emissions (Jorgenson et al., 2014).

4. Labour migration is associated with brain drain and abuses

In terms of labour mobility, while overall outcomes for countries of destination may be positive, countries of origin can face challenges imposed by migration, such as brain drain, where emigration of highly-skilled workers creates human resource deficits in key sectors such as health, or currency fluctuations caused by remittances stimulating large increases in imports.

Above all, migrants often suffer from abuse and exploitation which often constitute violations of internationally-recognised human and labour rights. For example, a recent study of South-East Asian migrants showed that over half had suffered one form of labour rights abuse, with more than 80 per cent of Cambodian migrants reporting one or more abuse, including withholding of wages and restrictions on movement (ILO and IMO, 2017). Migrants also face issues such as a lack of social protection in countries of origin or destination and de-skilling.

Abuses and negative outcomes are not inevitable; rather, they emerge from gaps in governance, such as the limited protection of migrants’ rights, a lack of means to ensure recognition of foreign qualifications and social protection systems that are not designed to address internationally-mobile people. In particular, where migrants are unable to migrate in a manner that is safe, orderly, or regular, they are particularly vulnerable to these negative outcomes.
III. MULTILATERAL DRIVERS OF GLOBALIZATION AND THE ROLE OF ASIA-PACIFIC

A. Stalled evolution of the multilateral trading system

The multilateral trading system was created in the aftermath of World War II in a bid to institutionalise international cooperation and set a regulatory framework to support global economic integration. Cooperation was initially based on the General Agreement on Tariffs and Trade (GATT), adopted in 1947 by 23 countries. Multilateral cooperation on trade gradually and substantially expanded through various rounds of negotiations over the following fifty to sixty years, but appeared to have stalled over the past decade, with countries turning increasingly to bilateral and regional trade agreements.

1. The multilateral trading system: 1947 to today

The creation of GATT followed the failed attempt to establish an International Trade Organization (ITO). The intention of the ITO was to create an institution to handle the trade side of international economic cooperation, complementing the two “Bretton Woods” institutions: the IBRD and the IMF. More than 50 countries participated in negotiations to create an ITO as a specialized agency of the United Nations. The draft ITO Charter was ambitious. It went beyond world trade disciplines to include rules on employment, commodity agreements, restrictive business practices, international investment and services. The ITO Charter was agreed in Havana in March 1948, but ratification in some national legislatures proved impossible. Despite the fact that the United States Government was one of the driving forces behind the proposal for the ITO, the United States Congress refused to ratify the Havana Charter. As a result, countries instead fell back on the supposedly interim arrangement of GATT, which became the only multilateral instrument governing international trade until 1995, when the WTO was established.

Multilateral trade system evolved through successive rounds of negotiations aimed to facilitate international trade through the reduction in tariffs (figure 1). The focus of the first few trade rounds were on tariffs, while the last two rounds (Tokyo, 1973-1979 and Uruguay, 1986-1994) covered a wider scope. Membership also expanded substantially over time. When GATT was replaced with the World Trade Organization (WTO) on 1 January 1995, there were 123 signatories. Today WTO includes 164 members, covering 95 per cent of global trade. There are 38 WTO members from Asia and the Pacific, with another five currently negotiating accession.

The WTO-based multilateral trading system, established as an outcome of the Uruguay round, has four main functions:

- Rules-setting platform (through deliberations and consensus based decision making);
- Platform for negotiations;
- Monitoring mechanism;
- Enforcement mechanism (Dispute Settlement Mechanism).
The WTO is known for its inclusive and horizontal structure and in some regard has perhaps fallen victim of a surplus of democracy. Over time, rules-setting changed from being captured by few (the infamous QUAD consisting of United States, European Union, Japan and Canada) to suffering greatly from a uniquely horizontal decision-making system where decisions are based on consensus among all (currently 164) members, with none having explicit veto power. While majority voting is possible, it has never been used. As discussed below, the negotiating function of the WTO has also weakened greatly. The effectiveness of the dispute settlement mechanism itself, which has been dubbed the “jewel in the crown” of WTO – has also come under threat over the past two years. Somewhat ironically and in contrast with the expectations at the time of WTO establishment, only its function as the monitoring mechanism in fact improved during the last decade, essentially due to the 2008 crisis and the search for alternative roles of trade and trade policies it generated.

The process of institutional transition of the trade system from GATT into WTO was accompanied by a substantial decline in applied tariffs (figure 18). However, the substantial decrease in tariffs was accompanied by a substantial rise in non-tariff measures (NTMs), such as technical barriers to trade and sanitary and phyto-sanitary measures. While putting in place these measures can in principle help achieve legitimate goals such as protection of human and animal safety or the environment, they may also be used as trade protectionist tools. These measures are less transparent than tariffs and their regulations and control through the WTO has been met with limited success. The stock of NTMs has risen significantly over the past decade and, in the Asia-Pacific region alone, 370 sanitary and 355 phytosanitary measures and technical barriers to trade were initiated in 2016.

Figure 18. Weighted-average world MFN applied tariffs on industrial products

Source: ESCAP’s compilation from World Bank WDI database and WTO presentation, available at: www.wto.org/english/tratop_e/tbt_e/program_fij06_e/s3_conc_def_princ_e.ppt

Post-WTO establishment, the Uruguay Round package was further improved by signing the Information Technology Agreement (ITA), in which 40 countries accounting for more than 92 per cent of world trade in information technology (IT) products, agreed to eliminate import duties and other charges on these products by 2000 (by 2005 in a handful
of cases). Similarly, in 1997, 70 countries covering more than 95 per cent of trade in banking, insurance, securities and financial information concluded a financial services agreement.29

The success of the Uruguay round became an important impetus for the decade of rapid development in trade globalization from 1995 to 2005. However, the progress of further liberalization under multilateralism slowed to a standstill in the Doha Round, which has become the longest negotiating round in the history of multilateralism. It started in 2001 with an incredibly most ambitious agenda, covering agriculture and services, non-agricultural tariffs, trade and environment, WTO rules such as anti-dumping and subsidies, investment, competition policy, trade facilitation, transparency in government procurement, intellectual property and a range of issues raised by developing countries related to the difficulties they face in implementing the present WTO agreements.

The increasing ambition and expanded thematic scope of WTO negotiations, as well as the inclusion of more countries that differed from each other in terms of development levels, economic structure and ambition of liberalization meant that reaching an agreement became more complex and more difficult to do in a single undertaking. In fact, arguably the only issue on which a breakthrough was achieved during the Doha round was trade facilitation, which was achieved by taking the issue out of the single undertaking. The WTO Trade Facilitation Agreement (TFA) could then be adopted in 2013, providing unprecedented implementation flexibilities for developing and least developed WTO members, along with promises of capacity building and technical assistance. The TFA entered into force in February 2017 after 125 countries had ratified it, among which 32 Asia-Pacific countries.

The success of the TFA aside, a divide among WTO members became obvious at the Nairobi Ministerial Council meeting in 2015, where many members reaffirmed their full commitment to conclude the Doha Round; but others, including some large developed countries, did not. The Eleventh Ministerial Council meeting in Buenos Aires, Argentina, failed to achieve a positive outcome of the Doha Round, thus casting a shadow on the entire multilateral trading system.

Today, the multilateral trading system faces considerable challenges. First, tariffs have only a limited scope to be further decreased. Second, faith in the Doha Round has been eroded and many seek alternative approaches to liberalization. Third, people suffering from the policy failure to distribute the benefits of globalization have finally made their voice heard, in particular in the developed economies who used to be leading rule-making and negotiations at the WTO. This has led to questions about the continued relevance of the multilateral trading system under this organization.

However, these developments do not mean that countries should depart from the multilateral system. A core value of the multilateral trading system is in providing a predictable trade environment. In industrial goods, the coverage of bound rates for developed countries increased from 78 per cent of product lines to 99 per cent from 1995 to 2005, and for the developing countries, the increase was considerable: from 21 per cent to 73 per cent. In agriculture, tariffs on all products are bound. Almost all import

restrictions that did not take the form of tariffs, such as quotas, were converted to tariffs. In addition, countries also committed to reduce domestic support and export subsidies on agricultural products. This meant a substantially lower level of uncertainty for traders and investors.

Another important contribution of the WTO to the global economy is in providing an international dispute settlement mechanism (DSM) where protectionist measures that are not consistent with WTO obligations can easily be challenged. From 2009 until present, the existence of an effective DSM and soft instruments such as the cooperation in G20 have kept protectionism at bay and prevented the global economy from running into a trade war. Since 1995, over 500 disputes have been brought to the WTO and over 350 rulings have been issued. A total of 102 members, 63 per cent of the membership, have participated in a dispute. The Appellate Body has upheld the rulings of dispute panels in 82 per cent of cases, modified the rulings in 14 per cent of them and reversed them in 4 per cent of cases.

2. **Preferential trade agreements as alternative to the multilateral trading system in Asia and the Pacific?**

In parallel to the development of the multilateral trading system, over the last few decades, there has been a global surge in preferential trade agreements (PTA), which is altering global trade rules. International trade is now mostly happening either under trade regulations unilaterally liberalized by countries or under their existing PTAs. In 2018, there were some 284 trade agreements in force globally. In the Asia-Pacific region, a total of 176 agreements are in force, which now comprise 66 per cent of the total global PTAs in force and thus indicate that the Asia-Pacific economies are the main contributors to the surge in PTAs. A further 77 agreements are under different stages of negotiations, while 10 agreements have been signed and are pending ratification and entry into force.

While the number of bilateral trade agreements has continued to grow, a relatively recent development is the negotiation of mega-regional agreements, encompassing a larger number of countries. Notably, the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP), was signed on 8 March 2018. Despite being reduced to 11 members after the withdrawal of the United States from the original Trans-Pacific Partnership in 2017, it is the most comprehensive free trade agreement in Asia-Pacific, accounting for 490 million people with average income per capita of almost $20,000, combined GDP of 10 trillion, 13 per cent of global GDP, and 15 per cent of global trade. It is also very comprehensive in scope, setting new ‘WTO+’ regulations in various areas, for example, on e-commerce, competition to allow for establishment of new networks and supply chains across the Pacific. This is particularly important against the current backdrop of weakening of global rules and disciplines which adversely affect trade arising from fragmented production across countries. Another even larger mega-regional agreement is the Regional Comprehensive Economic Partnership Agreement (RCEP), which could shape common trade rules among 16 Asian economies, including China, India, Japan and all ASEAN countries. A successful outcome of the RCEP negotiations – started in 2012 - would provide a unique opportunity to consolidate diverse and overlapping rules currently governing bilateral trade among the parties.

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31 Seven of those 11 are from Asia-Pacific region: Australia, Brunei Darussalam, Japan, Malaysia, New Zealand, Singapore and Viet Nam.
Figure 19. Asia-Pacific “noodle bowl” of preferential trade agreements
Can the WTO be made irrelevant by the growing web of PTAs, often referred to as the “noodle bowl” in Asia and the Pacific (figure 19)? This is not likely. Research suggests that the large number of overlapping agreements associated with different trade rules have created a complex web of trade rules even among the same trading partners. As a result, owing to different tariff schedules, rules of origin, documentation and procedures etc., transaction costs for businesses have increased, especially for small and medium-sized enterprises, and thus acted as impediments to exports under the PTAs. Furthermore, they also divert trade away from the economies not involved in the trade agreements, potentially leading to a higher level of inequality between countries included and excluded from these PTAs.

Importantly, unlike at the WTO where the use of special and differential treatment of members has become extensive to accommodate least developed countries, PTAs tend to be negotiated among larger or more developed economies, excluding least developed countries. Issues relating to disciplining export subsidies and domestic support in the agricultural sector, a sector crucial to employment and economic growth in developing countries, have also not been included in PTAs and can, therefore, only be handled through the multilateral trading system currently. Finally, although most of the PTAs cover handling trade disputes within the agreement, dispute resolution in PTAs has been generally much less effective than through the WTO DSM. Going forward, while the multilateral trading system is certainly not perfect, priority should be given to its improvement rather than to create parallel systems or turning to exclusive bilateral or unilateral fixes.

B. Managing financial globalization: Evolution of global governance and status of Asia-Pacific

While there is consensus on regulating finance, including the prudent use of capital control measures, reforming or updating the institutional framework underpinning global governance of finance has proved to be challenging. In fact, a truly transparent and inclusive multilateral framework has never been a reality. A reasonably successful example that came close was the Bretton Woods regime of international monetary and financial arrangements along with its supporting multilateral institutions such as the International Monetary Fund (IMF), which was put in place after the World War II.

Since its breakdown in 1973, the global economy has been in search of a stable new framework to manage financial globalization along with efforts to gradually reform the IMF. The pace of reform, however, has been slow and piecemeal. Despite recent measures, the representation and voice in decision making at the IMF is still not commensurate with the economic rise and influence of several developing and emerging countries, especially from Asia. Consequently, several countries have sought to rely on themselves by amassing foreign-exchange reserves, using bilateral credit lines in moments of vulnerability and developing regional arrangements.

1. The Bretton Woods regime: supremacy of capital controls and national priorities

The establishment of the Bretton Woods regime agreed to by 44 countries in July 1944 was a significant multilateral endeavour towards the end of the World War II, which shaped the global financial order for decades and influenced the future of international
economic interaction. The consensus view at the time was that unfettered capital flows undermined not only financial stability but also macroeconomic equilibrium and, therefore, that direct control over private capital movements, especially of “hot money”, was desirable for most countries.

The alternative of capital controls for floating currencies was rejected for two reasons. It was deemed that financial markets would create excessively volatile currencies driven by successive bouts of euphoria and pessimism, and that such currency instability and uncertainty would adversely affect international trade. After all, trade, not short-term finance, needed promotion. Thus, the established order was based on a system of fixed exchange rates; currency convertibility to gold (through the United States dollar); and removal of exchange restrictions and controls for current account transactions.

From the institutional perspective, new financial institutions – the International Bank for Reconstruction and Development (the World Bank) and the International Monetary Fund (IMF), were created, to: (a) provide long-term financing for economic development and reconstruction; and (b) provide short-term financing to help countries weather temporary shortages of foreign currency and difficulties in external payments. Before the creation of the IMF, such financing was arranged in an ad-hoc manner and depended on the availability and willingness of private creditors.

With the creation of IMF, short-term balance of payments financing became an official intergovernmental responsibility, and a central element in the multilateral financial system. Moreover, it was recognized that if a country’s growth and employment prospects came into conflict with its external payments, even after resort to capital controls and IMF financing – the “fundamental disequilibrium” – the incompatibility would be removed by adjusting the exchange rate rather than letting the domestic economy suffer. Thus, the multilateral institutional framework was built around the principle that domestic economic needs would trump the requirements of the global economy.

The same principle, however, became a source of its demise. A fundamental conundrum of the Bretton Woods regime was that a national currency – the United States dollar – effectively became the “global currency”. As the United States began to run deficits during 1960s, domestic and external, and Europe and Asia registered rapid economic and trade growth, doubts emerged on the United States guarantee to redeem dollars at a fixed parity against gold. Eventually, in August 1971, confronted with growing demands from foreign countries to convert their dollar holdings into gold, the United States Government suspended the convertibility of dollars to gold at a fixed price. Once again, the domestic economy had triumphed over the needs of the global economy.

2. Financial liberalization and floating currencies: increased volatility and instability

The inevitable collapse of the Bretton Woods regime due to its structural shortcomings and inability to cope with the growing world economy, alongside the subsequent move to a floating currencies regime in 1973, led to a significant increase in cross-border capital flows (Makin, 1974). This provided an impulse to a reformed multilateral framework based on economic liberalism and market-based ideas. By the late 1980s, capital controls had been removed in all the major European countries, making it the most financially open in the world. Similar strategies were soon deployed in other countries by multilateral financial institutions, led by the IMF. Financial assistance was tied to the liberalization and marketisation reforms, as illustrated by economic transformation in Eastern Europe.
...The role of Asia and the Pacific in Global Governance and Multilateralism (Sachs, 2005; Klein, 2007) and by the IMF assistance after the Asian financial crisis 1997 (Stiglitz, 2002).

Several developing countries tried to resist such drastic changes but were overwhelmed by foreign pressures. It was argued that liberalization of capital movements was both inevitable and desirable. Similarly, it was assumed that market-determined exchange rates and floating currencies were a double blessing; they would prevent currency misalignments while allowing countries to conduct their monetary policies independently. The new regime dramatically increased the influence of international financial markets and international institutions on domestic economic policy, and their clout continues to be very significant even today.

Such worldwide economic and financial liberalization significantly increased the volume of capital flows among countries. The daily volume of foreign currency transactions rose to $3.2 trillion by 2007, substantially larger than the volume of trade with a daily average of $38 billion in the same year. However, the opening-up of economies and rapid financial globalization made economies more interdependent and thus more vulnerable to external shocks.

In terms of governing global finance, the ability of financial markets to send correct signals was overemphasized, and there was little appreciation for the differences between domestic and international finance. Consequently, “excess volatility” and “misalignment” became bywords for floating exchange rates, and they became a source of instability rather than a safety valve. Indeed, the number of financial crises across the globe increased substantially; the most recent being the global financial and economic crisis of 2007-2008, the scale and severity of which the world had not seen since the great depression of 1930s. Among other implications, these crises have undermined the confidence and trust in the multilateral governance framework of global finance.

3. The Asian financial crisis of 1997: accumulation of foreign-exchange reserves and bilateral and regional arrangements

It is a well-established fact that the Asian financial crisis of 1997 was a product of hasty and imprudent financial liberalization, almost always under foreign pressure, which allowed free international flows of short-term capital without adequate attention to considerable risks associated with rapid financial globalization. Lack of domestic banking and financial regulations, together with no transparency on how much had been borrowed compounded the problem. Otherwise, the fundamentals of most of the crisis-hit economies were sound. Budgets generally showed surpluses, investments and growth rates were high, inflation was in single digits, and current-account deficits were small. In 1996, five of these economies (Indonesia, Malaysia, the Philippines, Republic of Korea and Thailand) had received net capital inflows of $93 billion. In 1997, they experienced an outflow of $12 billion, a turnaround of $105 billion in a single year, which amounted to more than 10 per cent of their combined GDP. It is worth noting that both India and China, which were experiencing high growth rates through the decade prior to the Asia crisis while rejecting the calls for complete elimination of capital controls, escaped the crisis altogether.

The crisis proved that financial globalization needs to be accompanied by adequate regulations, both at country-level and international level, preferably agreed in a multilateral process. Moreover, institutional mechanisms need to be in place to cope with
adverse outcomes if and when they materialize. During 1997, the government of Thailand sought assistance from the IMF, which imposed strict conditionalities that were severely contractionary for the economy. In any case, the IMF program failed to stem the crisis, and soon Indonesia, Malaysia, the Philippines and the Republic of Korea were engulfed in the crisis as well, revealing serious shortcomings of global governance of finance.

After the crisis, apart from undertaking domestic banking and financial sector reforms, several Asian economies began to accumulate foreign-exchange reserves as an insurance mechanism to deal with potential economic shocks and ensure financial and policy independence (figure 20). Accumulation of Asia-Pacific’s foreign-exchange reserves picked-up pace in the early 2000s amid rapid growth in China, India and the ASEAN economies and peaked at $7.4 trillion in 2013, before declining thereafter to $6.6 trillion in 2016. Most of the accumulation was placed in relatively risk-free, low yielding, short-term financial instruments of advanced economies.

Figure 20. Foreign-exchange reserves in selected countries and regions, 1990-2016

[Diagram showing foreign-exchange reserves for different regions and countries from 1990 to 2016.]

This process was predominantly driven by individual economies and involved little international coordination or cooperation, highlighting a critical deficit in the governance of finance based on a multilateral approach. Adding a layer of complexity, several economies have also sought to bolster their foreign-exchange reserves with bilateral swap lines and regional arrangements. The creation of a $240 billion multilateral fund – the Chiang Mai Initiative Multilateralization (CMIM) – by the 10 members of ASEAN plus China, Japan and the Republic of Korea is probably the best-known example of a regional arrangement. Members can draw on it to address balance of payments and short-term liquidity difficulties.

One fundamental and enduring lesson from the Asian financial crisis is that it is dangerous for a government to try to hold on to the value of its currency when financial capital is free to move in and out of a country. The option of full capital account convertibility and the desire to have stable exchange rates is just not sustainable and is only feasible if the domestic economy is willing to renge independence of its monetary and other domestic macroeconomic policies. Balancing the considerations put forward by this trilemma (stable currencies, free flow of capital, and independent monetary policy) has been a major challenge to global governance of finance.

Like the Asian financial crisis, it was a result of inadequate regulation of financial markets and regulators’ complacency. Financial institutions were able to take riskier decisions to pursue financial returns. When the bubble of the US subprime mortgage burst and individual borrowers defaulted, the impacts were quickly transferred to the financial institutions that had invested in mortgage-based securities. The ensuing liquidity and credit crunch spread to all credit and financial markets, and large financial companies went bankrupt. Through trade and financial linkages, the effects went beyond the United States and spread across the globe. In late 2008, trade plummeted and capital inflows to the emerging markets decreased sharply. Once again, weaknesses in the global governance of finance had been exposed.

Many countries responded by introducing conventional and unconventional monetary policies, including deep cuts in policy rates and quantitative easing measures. Massive fiscal stimuli were introduced as well. Countries bailed out or nationalized systemically important banks and financial regulations were strengthened. Even IMF had a change of heart and finally acknowledged that there are benefits to capital flow management measures.

The crisis once again highlighted failure of the IMF to effectively govern global finance. The risks associated with financial globalization were known: markets are prone to bubbles; unregulated leverage creates systematic risk and a lack of transparency undermines confidence. However, little effort was spared to alter the international institutional architecture and to mitigate those risk factors. Despite several earlier episodes of crisis in various parts of the world, IMF continued to believe that markets are efficient in all circumstances, financial innovations transfer risk to those best able to bear it, self-regulation works best and government intervention is mostly ineffective and harmful.

5. **Search for a re-design of global governance of finance continues: Asia-Pacific perspectives**

From an institutional perspective, the global financial and economic crisis of 2007-2008 increased mistrust of countries towards the international financial order and thus international institutions such as the IMF. Inevitably, multilateralism as an approach to broker the rules of international financial architecture was criticised. Nationalism increased and countries showed tendencies to revert to protectionist policies, increased regulations and interventionism to guide national development trajectories. The crisis, however, also resulted in “redesigning attempts”, as exemplified by the growing role of the G20 and the establishment of new financial institutions.

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31 Ahn et al. (2014) argued that the contagion effects of the financial crisis in 2008 were mainly through financial network, especially real exchange rate. Trade network contributed a negative contagion effect on some countries such as Latin American countries. Grant, E. (2016) reached a similar conclusion that the primary cause of financial crisis’s different impacts on countries was the countries’ heterogeneous exposure through financial channels. See also Changmo, A., Lee, G., & Chang, D. (2014). *The Global Financial Crisis and Transmission Channels: An International Network Analysis*. The South East Asian Central Banks (SEACEN) Research and Training Centre. Working Report 7.2014. Available at: https://www.seacen.org/publications/RePEc/7/2014-100349-00.pdf.

To draw meaningful lessons to improve global governance of finance, it is important to understand and acknowledge a fundamental difference between the Asian financial crisis of 1997 and the global financial and economic crisis of 2007-2008. Asian economies such as Thailand, Indonesia, Malaysia and the Philippines were on the periphery of the global system in 1997. Thus, when the financial crisis struck, they were blamed for their failures and their inability to adjust to the rigours of an economic system that thrived on financial globalization.\footnote{Similar negative assessments and wording were not used when a financial crisis of similar proportions was experienced by Sweden in 1992.}

However, when a major country such as the United States experienced a financial crisis in 2007, the system was blamed. Instead of pointing fingers at “crony capitalism”, efforts were initiated to reform the international economic system. Such differences in approach has raised serious questions about the ability and fairness of institutions that are responsible for managing financial globalization in a multilateral manner.

Thus, one key consideration in reforming global economic governance is to ensure the legitimacy of global institutions (Bretton Woods Project, 2014). A multilateral platform whose representation is exclusive or dominated by some of the world’s most influential developed countries is typically viewed as less legitimate. In this regard, the economic rise of the region is still not adequately reflected in multilateral institutions responsible for managing financial globalization. Table shows the IMF quota shares and IBRD voting share of selected Asia-Pacific economies. It highlights that while IMF quota shares of developing Asia-Pacific economies increased from about 15 per cent in 2004 to slightly over 21 per cent in 2016 (which is about the same as the region’s voting power in IBRD in 2018), representation by developing Asia-Pacific economies remained low relative to the region’s growing and substantial share in global economic output of close to 40 per cent.

Table 1. Quotas and voting power of Asia-Pacific economies in global financial institutions

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<td>Asia-Pacific countries</td>
<td>23.02</td>
<td>24.09</td>
<td>29.31</td>
<td>29.63</td>
<td>69.45</td>
<td></td>
</tr>
<tr>
<td>Asia-Pacific countries with special needs</td>
<td>1.24</td>
<td>1.22</td>
<td>1.21</td>
<td>2.31</td>
<td>5.87</td>
<td></td>
</tr>
</tbody>
</table>

Source: ESCAP’s calculations, based on AIIB (2018), International Monetary Fund, and World Bank.
Moreover, considering the global role of the IMF and the World Bank and their capacity to influence particularly small and less developed economies, there is an urgent need to increase the voting powers of Asia-Pacific least developed countries, landlocked developing countries and small island developing states, in the system. Yet, Asia-Pacific countries with special needs have experienced decline in their quota share despite developmental advancements.

Given the region’s limited representation in international financial institutions, it is not surprising that several Asia-Pacific countries have sought to rely on themselves by developing regional arrangements and creating new institutions. One prominent example is the New Development Bank (NDB). The NDB was established in 2014 by the BRICS states (Brazil, India, China, Russian Federation and South Africa), which have equal voting rights (NDB, 2015).

China has made considerable efforts to promote multilateralism at both the regional and global levels. The China-led Asia Infrastructure Investment Bank (AIIB) aims to improve social and economic outcomes for billions of people in Asia and beyond through investing in sustainable infrastructure. As of February 2018, 61 countries across the world have become its members, of which 40 are from the Asia-Pacific region (accounting for nearly 70 per cent of the voting power, see table 1). Another important China-led initiative is the Belt and Road Initiative (BRI), proposed by China’s President Xi Jinping in 2013, which aspires to provide a long-term transcontinental plan to deepen economic integration. Combining the Silk Road Economic Belt and the twenty-first century Maritime Silk Road, BRI aims to promote connectivity, unimpeded trade, financial integration, policy coordination and people-to-people bonds in Asia and the Pacific and beyond. An ESCAP study estimated that the economic gains across the six BRI corridors could be around 1 to 3.5 per cent of their combined GDP (ESCAP, 2017). Countries in the region could all make efforts to “grow open economies based on their national conditions, participate in global governance and provide public goods. Together, we can build a broad community of shared interests,” as China’s President Xi Jinping advocated in his speech in the BRI Forum for International Cooperation in May 2017.

In addition to increasing the representation of Asia-Pacific in global institutions and forums, reforming global economic governance involves other specific governance issues, such as World Bank’s allocation of grants and loans, the selection process of senior officials at the IMF and the World Bank, and permanent membership at the United Nations Security Council. While these issues are pertinent, the broader question is how to reform old global institutions so that they are in a better position to address new challenges arising from increased global interdependence. Section VII discusses this question in greater detail.

**C. Managing climate change**

Accelerating GHG emissions and climate change have widespread impacts on human and natural systems, making their management an important priority (IPCC, 2014). Nordhaus (2013) distinguishes two broad impacts of climate change, those on economic activities that will come at a large absolute cost but still be small relative to global GDP and global income growth and those on ‘unmanaged and unmanageable human and natural systems’. The latter, including sea-level rise, hurricane intensification, ocean acidification
and loss of biodiversity, will cause damage that is currently difficult to quantify and typically excluded from calculations of the cost of climate change (Jaffe and Kerr, 2015).

Climate change is a classic case of a global public good in that emissions of GHGs from any one country have the same effect on the atmosphere as those from any other country, and effective mitigation will not be achieved through individual countries advancing their own interests independently, even though mitigation can have local co-benefits, e.g. cleaner air. Indeed, individual actions will contribute only a marginal amount to alleviating the problem, thus there is a strong incentive to free-ride on the efforts of others.

Moreover, climate change has other distinct features that make it a particularly challenging public policy issue, especially that its management implies essential interests such as economic development; its nature as a global phenomenon in both its causes and consequences; its persistent impacts that develop over the long-run; uncertainties that prevent precise quantification of its economic impacts, and of the costs and benefits of reducing emissions; and the serious risk of major and irreversible change with non-marginal economic effects (Stern, 2006; Brooks, 2013; Baumert, 2006). Therefore, an effective response to climate change depends critically on international collective action to address the scale and urgency of the challenge; to manage our climate as a common resource and avoid free-riding; and this can also greatly reduce the costs of both mitigation and adaptation.

Climate change poses a threat to equitable and sustainable development because its associated risks are unevenly distributed between groups of people and across regions. Risks are generally greater for disadvantaged or marginalised people and communities everywhere, for example, decreasing regional crop yields or affecting water availability. The burden of adaptation to climate change falls disproportionately on the most vulnerable or is transferred to future generations.

1. Early efforts to manage climate change through multilateralism

The collective management of climate change has a relatively short history within multilateralism. The 1994 United Nations Framework Convention on Climate Change (UNFCCC) was ratified in 1994 and aimed to achieve the stabilisation of greenhouse gas concentrations in the atmosphere at a level compatible with the prevention of dangerous anthropogenic interference with the climate system. However, at that time, what this meant was not clearly defined.

The UNFCCC is the main multilateral forum focused on addressing climate change, with nearly universal participation, including across the Asia-Pacific region. It reflects global recognition of the climate change problem and the ultimate objective of global cooperation in stabilising GHG emissions, established principles of equity and responsibility and presents a positive vision of the integration of climate protection into national development plans and countries’ broader socio-economic development contexts.

The literature identifies three characteristics of an effective climate agreement, namely, broad participation (most GHG emissions should be covered), high ambition and strong

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36 Stern, N. (2006). In his analysis, Stern refers to reducing the risks of climate change as “the most important example of the provision of a global public good” [p. 451].
compliance (Bang et. al., 2016). Each is necessary but all three are needed to ensure effectiveness. Measured against these, the UNFCCC has been criticised as an agreement of “soft targets and loopholes” because it did not set firm governmental commitments and ultimately has been insufficient to achieve its environmental objective (Werksman, 1999).

In 1988, the Intergovernmental Panel on Climate Change (IPCC) was created, which gave the multilateral climate process its scientific basis. The IPCC, which has 195 member states, reviews and assesses the most recent scientific, technical and socio-economic information produced worldwide relevant to the understanding of climate change. Since its inception, it has issued five assessment reports, which have reflected the progress in the scientific understanding of the climate change phenomenon. Each assessment has strengthened the message that anthropogenic climate change is significant, growing rapidly and accelerating, and poses an imminent threat to ecosystems and livelihoods of billions of people.

The first legally binding international agreement on climate change was the 1997 Kyoto Protocol to the UNFCCC that entered into force in February 2005 and covered the commitment period 2008-2012. While all parties to the UNFCCC had a commitment to act on climate change, to promote technological development and to report periodically, member States with a commitment to reduce emissions – high-income countries (OECD members) and those in transition to a market economy – agreed to reduce their emissions over the five-year period from 2008 to 2012 to a level five per cent lower than their 1990 reference levels, according to an agreed formula for each country or regional bloc. This was intended as a first of many steps to increase ambition (Werksman, 1999).

Across the Asia-Pacific region, 49 countries ratified the UNFCCC and its Kyoto Protocol. Only four countries in the region set quantified emissions reduction targets relative to the 1990 base year, namely Australia (+8 per cent), Japan (-6 per cent), New Zealand (neutral) and the Russian Federation (neutral). Other countries in the region were exempt from legally binding targets for reducing emissions under this regime. Their GHG mitigation efforts were essentially voluntary and contingent on receiving financial support from developed countries. The expectation was that their participation in the international regime helped to build their capacity and experience which would build the basis for adopting more legally binding commitments in the future.

Efficiency considerations

The Kyoto Protocol established three flexibility instruments: international emissions trading, the Clean Development Mechanism (CDM) and Joint Implementation. Flexibility instruments offered countries an international market-based solution to achieve emissions reductions at the lowest possible cost. These provisions were arguably one of the reasons why developed countries were willing to take on substantial targets. Where countries with binding targets – or their private entities – had spare emission units, they could sell this excess capacity to countries that were over their targets via the carbon market, thereby minimising their compliance costs. This entailed full harmonisation of GHG measurement, reporting and verification (MRV) procedures to promote the accuracy of GHG accounting and compliance assessments across countries.
The Kyoto Protocol also established a set of multilateral institutions, e.g. the Conference of Parties, to govern implementation, promote compliance and enable the system to respond to evolving scientific knowledge or changing circumstances.

Countries in the region played a dominant role in the CDM. From the perspective of the developing countries in the region, this mechanism promoted investments by private-sector entities from industrialised countries in GHG-reducing projects in their countries, which allowed developed countries to credit the resulting emission reductions against their targets (figure 21). These could also be traded. Eligible investments in emissions reduction projects had to be “additional” to normal effort and provide sustainable development benefits for the host countries.

Figure 21. Investment in registered CDM projects in Asia-Pacific, 2004-2017, out of a regional total of $351bn, and as a percentage of national GDP

Figure 22 shows the scale of CDM in the Asia-Pacific region during the first commitment period of the Kyoto Protocol (KP1) which ran from 2008 – 2012. Approximately 85 per cent (6,062) of all global CDM projects were in the Asia-Pacific region, generating $351 billion of investments and substantial emissions reductions of around 6.6 Gt CO₂.

Figure 23 shows the extent to which the CDM supported emissions reduction efforts across the region, relative to a country’s actual emissions. While the amounts are not trivial, they are far from commensurate with the transformative scale needed to address the climate change challenge, taking into consideration economic development, population growth and other factors that have driven up annual emissions at a rate of around 3 per cent annually.

Figure 24 shows the importance of CDM to the economies of Asia-Pacific, using the ratio of the amount of emissions reductions units generated from the CDM projects hosted across the region to the GDP of the region.
Figure 22. Distribution of registered CDM projects by host, to 2012

![Pie chart showing distribution of registered CDM projects by host (Asia-Pacific: 1101 projects, Rest of the world: 6062 projects). Source: UNFCCC.]

Figure 23. Actual emission reduction: percentage of country emissions covered by estimated certified emissions reductions, Asia-Pacific

![Bar chart showing actual emission reductions for various countries in the Asia-Pacific region. Source: UNFCCC.]
Figure 24. Contribution of CDM to the economy: ratio of annual certified emissions reductions to GDP (2004-2017)

Figure 25. Price of emissions based on index of Certified Emissions restrictions (EUR per tonne of CO2)

Ultimately, the main achievement of the Kyoto Protocol is likely to have been its success in spreading awareness of the GHG implications of investment decisions, and its legacy of capacity-building across the developing world related to MRV.
By 2012, the Kyoto Protocol had lapsed and was not deemed a success. One of the main criticisms levelled against it was that its coverage only represented a small fraction of global emissions that were subject to restriction. Participation in the legally binding emission limitations was limited to a small set of countries, while most fast-growing countries – like China and India – were not covered by this emissions control system and this caused some member states to pull out of this multilateral process.

This is partly because the world had changed so rapidly during the two decades subsequent to the entry into force of the UNFCCC. In 1990, emissions of those countries that were subject to limits under the Kyoto Protocol represented about two-thirds of global emissions, of approximately 20KtCO₂eq, but by the time the agreement formally expired in 2012, only about 20 per cent or less of global emissions (which totaled 31KtCO₂eq) were subject to its restrictions. The reasons for this were, on the one hand, Asia-Pacific established itself as the world’s manufacturing hub which greatly increased its share of global emissions, mostly not covered by binding targets under the Kyoto Protocol, while on the other hand, the United States and Canada declined to ratify the agreement.

Second, its environmental effectiveness has also been questioned, due to concerns about the additionality of projects, i.e. whether projects brought about emissions that would not have been undertaken in the absence of the CDM, the validity of baselines that reflect what would have occurred in the absence of these projects and the possibility of emissions leakage.

Third, figure 25 shows the evolution of the carbon price over the period of the Kyoto Protocol. It took a deep dive in 2011 on the back of concerns of a supply glut in offsets caused, in part, by the economic downturn following the 2008 crisis and developments in the related European Union emissions trading scheme – the main market for emissions reductions units from the Kyoto Protocol. This showed a weakness in the multilateral system that failed to account for rapidly evolving external shocks. The collapse in the carbon price greatly diminished the incentive to participate in the CDM scheme.

Fourth, the project-based approach embodied in the CDM was transaction cost heavy and obtaining emissions credits proved to be a time- and cost-intensive process for project-developers, further diminishing incentives.

Finally, the CDM had little capacity to assist developing countries in achieving sustainable development – one of its core purposes. It did little to precipitate policy changes that could promote sustainable development in the host countries.

*What is a fair distribution of the emissions reduction burden?*

The climate problem is overwhelmed by multiple difficulties in determining what is fair. There is a disconnect between costly emissions reductions and measurable reduction of climate impacts. No single formula captures all dimensions of equity. Different formulae include those based on total emissions, per capita emissions, historic responsibility or income. These show different notions of fairness and proportionate burdens. This issue is further complicated by persistent scientific uncertainty in determining benefits to specific states and future generations that would accrue from near-term global action.
Underlying the multilateral climate change regime of the UNFCCC and the Kyoto Protocol is the equity norm of "common but differentiated responsibility" (CBDR) between developed and developing countries (Jentleson, 2012). It has a long history in international law (Williams and Montes, 2016; Stone, 2004). The norm affirms that all states share responsibility for addressing present problems but with respective shares varying based on each state’s contribution to the problem and relative capacity to contribute to amelioration. For example, under Articles 3 and 4 of the Convention, developed countries agreed to assume the lead in addressing the climate problem and to provide financing, technology and capacity-building to developing countries.

CBDR can be viewed as based on a notion of fairness, guided by the presumption that developed countries are disproportionately responsible for the historical climate change problem and have the greatest capacity to respond (Joyner, et. al., 2002). Nevertheless, both as a principle, and in terms of its practical usefulness in the context of the multilateral climate change regime, CBDR has been questioned. Other purposes for differentiation have been identified in the literature as recognising the special situation of one or more countries, recognising that countries may have different priorities and that a particular environmental issue may not be their top priority; or to satisfy a practical consideration of promoting broad participation in an agreement (Joyner, et. al., 2002).

The position of the Asia-Pacific region has been broadly supportive of CBDR. For example, one of China’s chief strategies for addressing global climate change was to uphold this principle, relying on several arguments, including its relative poverty, low per capita emissions, a low level of historical responsibility for the existing stock of GHG emissions and its need to pursue development (Bortscheller, 2010).

The CBDR norm has been successful in addressing historical legacies in global environmental policy. The 1987 Montreal Protocol (MP) on Ozone Depletion has been used extensively in the literature as an example of successful CBDR. The MP gave less-developed countries a grace period for complying with the Protocol’s provisions and established a fund to cover their incremental costs of implementation. The grace period could be invoked by a developing country whose per capita consumption of ozone-depleting substances was below a certain level. Once a country reached a certain stage of development, it lost its special status.

By contrast, as demonstrated by the outcome of the global negotiation in Copenhagen at COP15, it proved difficult and politically contentious in the case of climate change to agree on how differentiated responsibility should be and this ultimately contributed to the unravelling of the prevalent international climate regime (Hurrell and Sengupta, 2012; Rao, 2014). Unlike the MP where differentiation could change over time, the lack of provisions in the climate regime to take into account the evolution of emissions profiles of emerging markets was probably a fatal flaw.

Compliance mechanisms in international environmental law are weak

Compliance in multilateral environmental agreements and whether states have complied with the legal rules of a multilateral environmental agreement (MEA) can be divided into soft and enforcement approaches, with the latter relying on stronger tactics to deter non-compliance or to bring non-compliant states to compliance. While the former approach
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relies on the notion that compliance systems should focus on providing incentives in the form of financial and technical assistance rather than sanctions. Some scholars have questioned this approach, suggesting that the evidence of a high rate of compliance under MEAs applying a soft approach to compliance may be more due to their limited ambition of the commitments rather than to the effectiveness of this compliance approach. More ambitious MEAs, characterised by high short-term costs of compliance as in the case in the climate change regime, are likely to require more formal and more coercive enforcement strategies.

Many of the features of the Kyoto Protocol compliance regime are innovative, yet questions remain about its overall effectiveness (Werksman, 1999). While one of its most important achievements is to have institutionalised a process of enforcement in a neutral and independent body, the biggest question is whether penalties were sufficient to alter the incentives for strategic behaviour (Yang, 2006).

Due to the Kyoto Protocol’s legally binding character and the flexibility mechanisms which carries with them the need to assure traders in allowances and offsets that the benefits of their bargains will be backed by a rule-based response, the compliance mechanism of the UNFCCC and Kyoto Protocol contains elements of public and private law. On the one hand, the formal compliance and enforcement mechanisms are grounded in public international law, but also generates derivative legal relationships whereby emissions allowances and offsets could be transferred between states. These fall under the jurisdiction of domestic law or private international law that governs transboundary commercial transactions.

2. The Paris Agreement provided new impetus to the multilateral approach on climate change

The 2015 Paris Agreement on Climate change is viewed as a major success in multilateral diplomacy. In contrast to the previous global governance arrangements under the Kyoto Protocol, the Paris Agreement does not compel countries to meet specific emissions reductions targets in a top-down way. Instead, all countries are left to themselves to determine nationally, and in line with their capabilities, their contributions to reducing emissions as part of a bottom-up pledge and review system. To date, 175 Parties of a total of 197 Parties to the UNFCCC have ratified the Paris Agreement, and it covers close to all global emissions.

From the perspective of the Paris Agreement, its inclusiveness and broad participation are its main success factors. Yet, these may have been achieved at the expense of vagueness of obligations and substantial discretion (Keohane and Oppenheimer, 2016). While it helped to facilitate agreement, the most contentious issue of how to share the reduction burden was not addressed. Indeed, current levels of ambition contained in the Nationally Determined Contributions (NDCs) collectively fall far short of what is needed (UNEP, 2016). The NDCs are not aligned to the science, which prescribes the emissions reductions paths needed to achieve the globally-agreed temperature goal contained in the Paris Agreement.

It also suffers from weak compliance and enforcement mechanisms partly because emissions reduction pledges are essentially voluntary. The Paris Agreement contains provisions to enhance long-term effectiveness. Each country is required to track and report its progress towards implementing its NDC, which are subjected to a successive
review process where NDCs are meant to represent a progression in ambition. There is also a collective provision to track progress towards the long-term goals through the global stock take. However, the Agreement provides no material consequences to be implemented against a country that fails to fulfil its NDC. Compliance measures are intended to be non-punitive and non-adversarial. Its effectiveness will therefore depend on the inclination of governments to take costly action and on the progress of enabling technologies.

3. **International climate change cooperation has now branched beyond the UNFCCC**

Climate action has been undertaken outside of the UNFCCC context for a while, focusing on the developments in three other international legal regimes, namely the International Civil Aviation Organization (ICAO), the International Maritime Organization (IMO), and the Montreal Protocol; through the rise of “minilateral” climate coalitions to address climate change; and through initiative undertaken by non-state actors (Van Asselt and Bößner, 2016).

Commentators increasingly refer to the international climate change governance as a “regime complex” rather than a single regime (Maljean-Dubois and Wemaëre, 2017). The new multilateralism is seen as more fluid than what we are used to (Haass, 2010). The complex includes numerous public and private institutions and initiatives which operate at international, regional, national or sub-national level. The multilateral negotiations under the Conference of Parties to the UNFCCC are no longer the only forum for climate change negotiations, indeed part of the negotiation process will be conducted through “minilateral” fora involving a small number of countries, such as the G-20 or the 17-strong Major Economies Forum (MEF) (Falkner, 2016; Haass, 2010).

Most proposals advocate for the inclusion of major emitters that possess economic weight and political influence, implying a large role for the region. On the basis of criteria such as the share of global emissions, the share of global GDP, and the share of global population, China, the Russian Federation and India would be among the top 10 for all three indicators; Japan would reach the top 10 in regard to two indicators; while Australia, Bangladesh, Indonesia, Islamic Republic of Iran, Pakistan and the Republic of Korea from the Asia Pacific region would all be in the top 10 on the basis of just one indicator.

These climate “clubs” can be complementary to the multilateral system in that they help overcome several of its shortcomings including its cumbersome and slow bargaining process that gives veto power to too many players; its inability to create incentives for emission reductions and prevent free-riding. Although minilateralism is deeply controversial, particularly among smaller developing countries that fear being excluded from the negotiation process, and raises legitimacy concerns, it can create opportunities for high-level political dialogue that helps to build trust and explore areas of potential compromise. It also helps to maintain the political momentum.

The advantages of a complex include greater stability and potential for higher ambition. As shown by the recent announcement of withdrawal by the United States from the international climate change regime, the regime easily withstood this shock. Involving a greater number of actors also offers potential to increase ambition towards the globally-agreed goals.
From this perspective, the international regime should play the role of catalysing this complex to raise the level of ambition and strengthen coherence, ensure complementarity and avoid duplication. It must also address how to measure and link the contributions of different actors in the complex to the NDCs.

The challenges of a complex include some loss of control over the direction of the action, but there are also questions of a lack of legitimacy of non-state actors who are not formal contracting parties to the international regime.

The Montreal Protocol is a complementary instrument to tackle aspects of climate change

The Montreal Protocol on Substances that Deplete the Ozone Layer is an international treaty designed to gradually eliminate the production and consumption of ozone depleting substances to limit their damage to the earth’s ozone layer. The agreement was negotiated in 1987, and went into force in 1989, having been revised several times. The Protocol, ratified by all the states in Asia-Pacific, reached a global agreement on phasing out Hydrofluorocarbons (HFCs), which are powerful GHGs. The Meeting of the Parties agreed to an international phase-down of 85 per cent of HFCs, equivalent of up to 72 billion tonnes of carbon dioxide by 2050, or well over a year’s total greenhouse gas emissions (table 2).

Table 2. Summary of Montreal Protocol commitments

<table>
<thead>
<tr>
<th>Ozone depleting substances and potent GHGs</th>
<th>Developed countries (Non-Article 5)</th>
<th>Developing countries (Article 5)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Chlorofluorocarbons (CFCs)</td>
<td>Phased out end of 1995</td>
<td>Total phase out by 2010</td>
</tr>
<tr>
<td>CCl4 (Carbon tetrachloride)</td>
<td>Phased out end of 1995</td>
<td>Total phase out by 2010</td>
</tr>
<tr>
<td>Hydrochlorofluorocarbons (HCFCs)</td>
<td>Freeze from beginning of 1996b</td>
<td>Freeze in 2013 at a base level calculated</td>
</tr>
<tr>
<td></td>
<td>35 per cent reduction by 2004</td>
<td>the average of 2009 and 2010 consumption levels</td>
</tr>
<tr>
<td></td>
<td>75 per cent reduction by 2010</td>
<td>10 per cent reduction by 2015</td>
</tr>
<tr>
<td></td>
<td>90 per cent reduction by 2015</td>
<td>35 per cent reduction by 2020</td>
</tr>
<tr>
<td></td>
<td>Total phase out by 2020</td>
<td>67.5 per cent reduction by 2025</td>
</tr>
<tr>
<td></td>
<td>Total phase out by 2030</td>
<td></td>
</tr>
<tr>
<td>Hydrofluorocarbons (HFCs)</td>
<td>10 per cent reduction by 2019</td>
<td>Freeze in 2024</td>
</tr>
<tr>
<td></td>
<td>30 per cent reduction by 2024</td>
<td>10 per cent reduction by 2029</td>
</tr>
<tr>
<td></td>
<td>70 per cent reduction by 2029</td>
<td>30 per cent reduction by 2035</td>
</tr>
<tr>
<td></td>
<td>80 per cent reduction by 2034</td>
<td>50 per cent reduction by 2040</td>
</tr>
<tr>
<td></td>
<td>85 per cent reduction by 2036</td>
<td>80 per cent reduction by 2045</td>
</tr>
</tbody>
</table>

Source: Australian Government, Department of Environment and Energy.

Consumption and production is phased-out in a step-wise manner, with different timetables for developed and developing countries (referred to as “Article 5 countries”). In Asia-Pacific Non-Article 5 countries include: Australia, Azerbaijan, Japan, Kazakhstan, New Zealand, Russian Federation, Tajikistan and Uzbekistan. The remaining countries are considered Article 5 parties.
The International Civil Aviation Organization is the forum for tackling emissions from international aviation

While emissions from domestic aviation are covered by the UNFCCC process, the Kyoto Protocol mandate developed countries to discuss measures to mitigate international aviation emissions through ICAO. The primacy of ICAO to address international aviation emissions was confirmed by the omission of the sector from the Paris Agreement. ICAO has significant experience in setting international standards in the sector, including on aviation emissions. In 2010, ICAO adopted a global goal of improving annual average fuel efficiency by 2 per cent and an aspirational goal of keeping global carbon emissions constant from 2020. On the back of the inclusion of aviation emissions in the European Union's emission trading system in 2013, ICAO adopted a global MBM in 2016, the Carbon Offsetting Scheme for International Aviation (CORSIA).

Figure 26. Countries in Asia-Pacific voluntarily participating in the global MBM scheme of CORSIA from its pilot phase (2021-23)

Participation of states in the pilot phase (2021 to 2023) and first phase (2024 to 2026) is voluntary (figure 26). For the second phase from 2027, all states with an individual share of international aviation activity in year 2018 above 0.5 per cent of the total are included. Least developed countries, small island developing States and landlocked developing countries are exempt unless they volunteer to participate.
The International Maritime Organization is the forum for tackling emissions from international shipping

As with aviation emissions, the Kyoto Protocol delegated the regulation of emissions from international shipping to the International Maritime Organization (IMO). To date, there is a mandatory Energy Efficiency Design Index (EEDI) for new ships in place and all ships are required to have a Ship Energy Efficiency Management Plan. These standards apply to ships flagged under countries signatories of the MARPOL Annex VI, which in the Asia-Pacific includes Australia, Bangladesh, China, Cook Islands, Japan, Kazakhstan, Marshall Islands, Republic of Korea, Russian Federation, Singapore, Tuvalu and Vanuatu. These measures are expected to yield in the region of 13-23 per cent relative to BAU between 2020 and 2030 (UNEP, 2016). Market-based mechanisms continue to be discussed but there is at present no consensus on their use within the IMO.

Non-state actors play an increasingly important role in raising climate ambition and financing

Non-state actors (NSAs) play a variety of roles in the context of the international climate regime, especially in the implementation and financing of climate action.

The Asia-Pacific region is also promoting climate action agendas through multi-stakeholder fora. These action agendas have the potential to unite the spectrum of stakeholders around thematic priority issues to enhance regional climate action and increase ambition. For example, the G20 Financial Stability Board’s Task Force on Climate-Related Financial Disclosures calls on lenders and investors to disclose their management of climate risk as part of their main financial statements. In our region, a number of public agencies and companies have already signed up to these principles and it is only a matter of time before this becomes the norm for private-sector companies and investors across the region. This will catalyse the shift towards sustainability and make investment decisions by companies and investors more sustainable. Another example is the Sustainable Banking Network, which 17 countries in our region have joined to mainstream sustainability through their banking systems by launching policies, guidelines and roadmaps. All these initiatives form part of the effort by countries in the region to achieve decarbonisation by mid-century. The NAZCA platform, hosted by the UNFCCC, captures the commitments to climate action by companies, cities, regions, investors and civil society organizations, and aims to track the actions that are helping countries achieve and exceed their national commitments to addressing climate change.
IV. CONCLUSION - A WAY FORWARD

This final section offers a forward-looking perspective on the role of the Asia-Pacific region in promoting a more effective globalization and representative multilateral mechanisms. Given its size and growing economic and political clout, there is no doubt that the Asia-Pacific region will play a key role in the globalization of the 21st century and in the adjustments taking place in multilateral institutions to respond to changes. Looking forward, one may expect an increase in the value of inter-regional trade, especially in services, which is still low and the expansion of FDI flows into the region. Further development of the region’s domestic financial and capital markets so that countries are better prepared to pursue greater financial market integration within and outside the region can also be expected. It remains to be seen what the impact of technological advancement and mechanisation will be for the region’s manufacturing hub.

Although the region may have expressed dissatisfaction about the existing global governance frameworks, it does not have a clear and coordinated proposal on what the alternative arrangement should be (Cho, 2012). Moving forward, the region could play a greater role in setting global rules, take the lead in ensuring an open and well-functioning global economic system (such as trade and investment flows), continue stepping up its support to the developing countries (through enhanced connectivity, financial support or sharing regional knowledge) and take greater responsibility of global economic issues (even if such action might temporarily undermine its economic performance).

Broad principles to move forward with globalization and strengthening multilateralism are essentially two-fold. Firstly, diversity must be respected, both in terms of the prerogative of national governments in choosing the speed with which they may want to pursue globalization, and in their approaches in managing it and cooperating with each other. This does not need to invalidate the overarching principles that guide the multilateral institutions. Basically, a one-size-fits-all approach should be avoided. Secondly, accountability must be strengthened by increasing the representation of developing and emerging economies in multilateral institutions.

In trade, many economies in the region especially the least developed countries, are still not part of the global production networks and still face high trade costs. Hence, the process of globalization needs to be made more inclusive. The multilateral trading system apt for the 2030 Agenda will be the one to support what are clearly different needs and priorities as well as unequal implementation capacities of its members. The recent success of WTO Trade Facilitation Agreement (TFA), with its variable form of conditionality and flexibility regarding implementation modalities (as well as provision of technical assistance), provides a noteworthy example for the future direction of the multilateral trading system. Learning from the TFA, as well as from many of the bilateral and plurilateral trade agreements, Asia-Pacific economies should contribute to enhancing the WTO multilateral trading system by embracing variable geometry (that is, no-one-model-fits-all) yet insisting on the core principles of non-discrimination, transparency and predictability of rule enforcement. The new norm for multilateral trade diplomacy (Sauve, 2017) should be open plurilateral and sectoral agreements that are negotiated transparently inside the WTO and whenever possible lead to multilateralization of commitment benefits.
Furthermore, given that an acute risk today appears to be arising from re-introducing damaging protectionist policies such as voluntary export restraints, orderly marketing arrangements, quotas and other instruments of managed trade, Asia-Pacific countries should prioritize:

- Defending the WTO’s dispute settlement mechanism by refusing unilateral retaliatory actions and instead building alliances with other WTO members and preserving the spirit of international cooperation (and not confrontation) which has pinned the multilateral trading system for 70 years.

- Switching priority from negotiation of liberalization to rules-setting. This is especially important for smaller developing countries which typically have some resistance to embracing new issues or areas on the multilateral trade agenda. However, the success of the TFA should encourage them to pro-actively seek new rule areas or new modalities for implementation which can lead to the reduction of their trade costs, improvement of competitiveness and increased benefits from trade.

- Nurturing and strengthening regional and plurilateral institutions and agreements providing intergovernmental platforms for building consensus and reducing capacity gaps on trade-related matters among countries of the region, and fully utilize them as building blocks towards a more effective and relevant multilateral trading system. For example, innovative provisions or commitments in existing regional or plurilateral agreements could be identified and the WTO could provide a modality for these commitments to be multilateralised or applied to other relevant sectors.

While deliberating on future directions of financial globalization and a multilateral approach underpinning it, five insights need to be kept in view.

First, financial globalization should be regulated, including through prudent use of capital flow management measures. This is because unregulated and unfettered financial globalization brings significant costs to economies. Adequately managed “moderate” financial globalization can help to maximize its potential benefits. It is important that a sound and effectively regulated domestic financial system precede regional or global financial integration.

Second, accumulated historical experience since the creation of a multilateral institutional framework of Bretton Woods, suggests that domestic economic needs always takes precedence over requirements of the global economy in times of financial crisis. Indeed, balancing domestic policy priorities and politics against a more integrated and open global economy is a very difficult task, and a fundamental challenge in giving shape to the future of financial globalization and multilateralism.

Third, institutions responsible for managing financial globalization should not promote or impose uniform economic ideologies and associated economic policies for all countries. For instance, the IMF has promoted financial liberalization as an optimal policy for all countries since the 1990s onwards, irrespective of individual country circumstances or priorities, until very recently. Such a one-size-fits-all approach should be avoided because it erodes trust in multilateralism and raises doubts about the potential benefits of financial globalization.
Fourth, a pluralistic approach, which acknowledges the priorities of individual countries in terms of their preferred speed of integration and accommodates regional or sub-regional arrangements should be encouraged. Such an approach does not need to impede financial globalization, but can contribute to a more equitable and balanced global financial architecture by aligning smaller economies within regional blockings. This pluralism may contribute to the multilateral process of redesigning a global approach to govern financial globalization more effectively.

Finally, the world economy and global politics have fundamentally changed over the last 70 years. New approaches to governing financial globalization and re-designing multilateralism should respect and accommodate these changes. Specifically, in the context of this report, the centre of economic gravity has shifted decisively towards Asia and the Pacific, yet this is still not adequately reflected in multilateral institutions responsible for managing financial globalization, in terms of their representation and voice in decision making.

For multilateralism to prevail, it must duly reflect its stakeholders (Kwakwa, 2017) and thus resolve representation issues. To enhance accountability of globalization and multilateralism, the treaty-based (“hard”) multilateral organizations, such as the World Bank and the IMF, should continue their reforms with inclusiveness as the foundation. Moreover, enhancing accountability of multilateral organizations requires clear definitions in terms of what areas these organizations are accountable and responsible for. Although the international financial institutions have specific mandates, e.g. the IMF promotes international monetary cooperation and financial stability, while the World Bank promotes long-term economic development, prosperity and poverty reduction (IMF, 2018), the expansion of working areas of these institutions in other issues has blurred the boundaries. As a consequence, accountability of these institutions has weakened.

The voluntary (“soft”) governance frameworks are critical complements, especially when innovation is needed or a subset of countries is required to take ad hoc actions. G20, for example, has supported the WTO to combat protectionism in recessionary times, and is involved in institutional reforms of the IMF and the World Bank (Kirton, 2010). It was upgraded from finance ministers level to heads-of-government level, as a response to the global financial crisis of 2008 that needed a coordinated global policy response. Similarly, the role of G77 has been emphasized to promote collective economic interests of the countries of the South and to enhance South-South cooperation for development (Liangyu, 2018; G77, 2018).

Moreover, role of several regional and subregional ‘soft’ governance frameworks needs to be accommodated as well within an improved multilateral framework. For instance, NDB and AIIB have become new multilateral partners in addressing infrastructure needs of developing countries. With its Belt and Road Initiative, China has introduced a new way to deepen economic integration by improving transport and trade connectivity and infrastructure investment on a trans-continental scale (Kwakwa, 2017). The Chiang Mai Initiative Multilateralization (CMIM) provides multilateral currency swap arrangements among the ASEAN+3 to manage regional short-term liquidity problems, as well as to facilitate the work of other international financial arrangements and organisations, such as the IMF.
Regarding **climate change**, the Paris Agreement offers a new multilateral framework through which the global community can potentially achieve the science-driven global temperature targets needed to keep warming within safe levels. The jury is still out on whether the multilateral approach through the Paris Agreement can achieve its stated aims. There is no room for complacency. While its major strength is its broad participation, it reflects low ambition and there is a substantial gap between the Agreement’s collective aims and the sum of the parties’ individual NDCs.

Some commentators take the view that substantial emissions cuts will not depend on the text of the Paris Agreement but much more on domestic and transnational politics within and between the OECD countries and the BRICs. Indeed, the Paris Agreement can be viewed as opening “the door to progress on climate but does not assure it” (Keohane and Oppenheimer, 2016). In particular, vigorous emissions cuts by developed countries – including those in the region – are needed to lead the way.

Governments from major emerging countries in the Asia-Pacific region that are heavily affected by climate change or air quality clearly have an incentive to act on these issues. Their interests would be served by action on climate change by developed/OECD countries, which they are likely to recognise as being contingent on their own commitments. Because their principal focus will be on economic growth and minimising the costs to their countries, they will aim to keep their own commitments as flexible as possible. Their main leverage point is their huge current and prospective emissions and their ability to decide to what extent to reduce them. Therefore, they are likely to continue to seek financial and technological assistance to help relax their own national constraints.

Governments from poor, smaller states have an interest in seeking a “pledge and review” system that is focused on the major polluters and provides them with full flexibility in terms of their own actions, while receiving monetary compensation from developed countries. Their bargaining power will be their ability to appeal to a fair solution as their own climate action is unlikely to have a bearing on the commitments of developed countries.

For the system to work, ambition and compliance need to be strengthened. In the context of a “pledge and review” system, this means clear expectations that pledges will be regularly upgraded and substantial transparency will ensue so that compliance with pledges can be monitored. It means countries taking action to punish those that fail to make serious commitments or renege on them.

The record for countries adhering to climate change commitments without strong international enforcement – like the Paris Agreement – is not impressive (Bang et al., 2016). Pledge and review systems depend critically on transparency so that countries have a reputational stake in taking costly action on climate change and revising their ambitions upward. To date, there are still gaps in the transparency framework, for example, the metrics being used to define national emissions reductions targets vary considerably, with some countries defining absolute emissions reductions vis-à-vis a base-year or as an emission quantity and others choosing relative emissions reduction goals for the target year 2030, relative to a “business as usual” (BAU) scenario, others still as improvements in energy efficiency, as carbon intensity reductions, peak of carbon emissions or policies and actions that contribute to GHG emission reductions. This diversity makes it difficult to assess and compare ambition and identify the collective ambition gaps and work needs to be done under the multilateral umbrella to clarify and harmonise the framework.
Increased climate ambition can also be engendered through the provision of finance, technology and capacity-building. The country-led approach pursued by the Paris Agreement resulted in the formulation of emissions reduction pledges by developing countries – previously not bound to reduce emissions – that are contingent on receiving financial support, especially those aimed at raising ambition beyond the level at which countries are willing to reduce emissions without incentives. Developed countries – including those in the Asia-Pacific region – should not pass up this chance.

Moreover, ambition can be increased by widening the spectrum of actors from states to other stakeholders, especially those that can have a potentially large impact on reducing emissions, such as cities, provinces, municipalities, and, very importantly, private-sector entities. Indeed, research shows that three-quarters of global emissions are the result of just 250 companies and half a dozen large economies. More needs to be done to target the big emitters in the Asia-Pacific region.

It is also important to make a better economic case for the opportunities contained in the NDCs to both the business and donor communities through enhanced advocacy. While it is necessary to find a common metric to monitor collective progress towards requisite emissions reductions both by states and signatories of the Paris Agreement, this is equally important for non-state actors to create a connection between their reduction efforts and the NDCs to gauge progress towards the collective goal. A common metric is especially important if the internationally transferable mitigation outcomes (ITMOs) foreseen by the Paris Agreement are to take off as a cost-efficient solution to achieving the NDCs.
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Notes: