

US Economic Diplomacy – A View from Afar

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“...the only serious threat to the real interests of the United States can come from a failure to adjust sensibly to the newer world order.”

Paul Kennedy, 1987²

INTRODUCTION

The transition of power among nation states creates great complexity and challenges for governments – for the incumbent powers, for the rising ones, and for those countries which are spectators to the transition.

The world is currently in the midst of a marked shift in economic weight from the countries of the trans-Atlantic toward those of Asia. Emerging Market Economies (EMEs) have been supplying around $\frac{3}{4}$ of annual world growth in recent years - they already comprise half of world GDP and are likely to be approaching 60 per cent by 2030. Much of EME growth is driven by Asia, especially China.

This phenomenon raises challenging questions for the United States about its role in Asia, and more generally, and how it should respond to the efforts of EMEs, especially China, to play a more assertive role in world affairs. Chief among these questions include: whether the US can adopt the same posture in the region as in the past; what responsibilities it can, and should, expect China to take on; and what role the rest of the region should be expected to play over the decades ahead.

¹ This paper has been long in gestation and the ideas reflected in it have been developed through many conversations with individuals too numerous to mention. I would like to express my appreciation, though, to three people who have particularly influenced my thinking about international and strategic issues over the years: Allan Gyngell, Heather Smith and Peter Varghese, none of whom can be held responsible for the views expressed here.

² *The Rise and Fall of the Great Powers*, Random House, New York, p534.

Whether, and how, to deploy power is always a conundrum and never more so than in a fluid and changing environment. Today I want to focus on the importance of economic diplomacy and the evolving role of new and incumbent powers. While much of this discussion can be generalised, I will focus particularly on Asia, drawing on my own experience as a practitioner of economic diplomacy.

Let me start with three propositions.

First, the transition of economic weight from the trans-Atlantic toward Asia is playing out in real-time and challenging the institutions and rules that have governed global economic activity over the last 70 years. In particular, EMEs have become more vocal about the failure of existing institutions and governance arrangements to satisfy their objectives, leading to pressure to “rewrite” the rules and for the creation of new institutions.³

While it is important to acknowledge that the global rules are always being re-made, much of this is evolutionary and is in the nature of re-tuning in response to economic developments – in contrast, this challenge goes to the heart of who writes the rules, not just the rules themselves.

Second, economic weight does not automatically bestow global strategic power or influence. Accordingly, the key issue is not whether the US is in relative economic decline or whether we are seeing the end of the American Century. The US will remain central to efforts to galvanize institutions and other nations to address global challenges and to deliver global public goods.

But the diffusion of power, both among nation states and from nations to non-state actors, means that the US will need to operate differently than in the past if it is to achieve success. In particular, it will need to be more strategic in identifying its core national interests and to be more agile in its response to events. As Joseph Nye has noted, in this emerging world ad hoc reactions to

³ Indeed, Michael Wesley has explicitly suggested it is time to question the “longevity not only of the content of international order but of its global extent.” *Feudal world ahead if great powers establish exclusive spheres of influence*, The Weekend Australian, September 5-6, p18. Drawn from *Restless Continent: Wealth, Rivalry and Asia’s New Geopolitics*, Black Inc., 2015.

events will not be enough - success means the US needs a 'smart power strategy'.⁴

The rising importance of non-state actors reflects a number of factors, but in large part has been enabled by developments in information technology. The information revolution has brought significant benefits – greater community engagement via social media, for example – but it has also enabled the easier creation of communities of (inimical) interest while media savvy entities such as IS have been able to extend their reach beyond historic constraints. Both these positive and negative developments strain government's capacities to respond carefully to unfolding events.

Third, if a strong international order is a worthwhile objective, change to global economic governance arrangements is not only inevitable but necessary. Failure to recognise this risks eroding countries' influence and capacity to achieve national objectives. However, at this stage there is no clarity about how such an evolved order might look, nor how the transition to it can be best managed. This throws up multiple questions without answers, at least to date: will it be more or less liberal than in the past?; will it have a greater range of "acceptable" modes of behaviour?; how should economic diplomacy be conducted in such an environment?; and what capabilities do our institutions and policy makers (including diplomats) need to be successful in such an environment?

THE FOUNDATION OF ECONOMIC DIPLOMACY

The long-term forces that shape the destiny of countries are fundamentally economic – the response to globalisation, demographics, human capital, an innovative and entrepreneurial culture, the strengths and effectiveness of domestic institutions and the quality of the rule of law – and, arguably, are little changed over the last two centuries. Failing to recognise this economic underpinning, and failing to pursue policies that foster dynamism, help manage shocks, and deliver citizens what they desire and value, risks the capacity to project power and sustain influence.⁵

⁴ Joseph S. Nye, Jr, *Is the American Century Over?*, Polity Press, Malden MA, 2015, p125.

⁵ Note that nowhere here is foreign market access defined as a measure of success, yet a recurring theme of trade negotiation is to achieve improved market access, which is touted as a source of future economic dynamism and

Accordingly, economic success is a necessary, but not sufficient, condition for the sustained deployment of power and the achievement of influence.

Without economic success, countries will not have a track record of high employment and rising living standards, of sustained and stable growth, to which others may aspire to emulate. Without economic success, a country will also lack the resources able to be sustainably deployed to influence others – whether they be military assets, aid programs, cultural and social outreach, or even the effective distribution and use of missions and diplomats.

How countries choose to deploy their economic resources is key, as the relation between economic success and power projection is neither mechanistic nor linear.

Clearly, sustained economic success can provide resources that can be used to deploy strong military or other forward-projected forms of power. But equally, countries can erode their capacity to achieve economic success for a long period of time, diverting resources from productive activities to military assets, men and equipment. The former Soviet Union was a clear case of a nation able to project military power for a long period in the absence of good economic performance, but at the cost of immiserating its people and sowing the seeds of its own collapse.

Economic success also influences the capacity to project soft power – countries without rising living standards are unlikely to be able to enrich the world with the key cultural industries, values, and foreign policies that constitute soft power. However, economic success does not guarantee soft power success if the underlying social model lacks other desirable characteristics. The US has a long track record of developing and projecting soft power well – the Soviet Union did not and, to date, modern China also appears relatively unsuccessful.

opportunity. In fact, the vast majority of the benefit supposedly flowing from free trade agreements can be achieved by unilateral action since they arise from improved allocative efficiency in domestic markets as a result of additional competition, not because a country can sell an additional tonne of beef or another machine tool.

Whether countries choose to deploy power is dependent on a range of other issues. US isolationism during the interwar period could be seen as a failure of power conversion though, to me, this appears to have been a perfectly legitimate and deliberate policy choice rather than a sign of inability⁶. In contrast, Japan's extensive aid program and sustained public diplomacy over decades appears to have had only limited success, suggesting other factors have undermined its capacity to achieve the outcomes sought. Similarly, while China has been gaining economic strength for some time, it had shown little evidence until the last few years that it was interested in deploying its strength to influence others.⁷

Interdependence, as a result of globalisation of trade, capital and labour markets, brings with it great benefits for the global economy but also creates new complexities for countries in the pursuit of their national interests. In particular, rising interdependence combined with the increasing economic weight of China and other EMEs, requires Western nations, and particularly the US, to develop a more dynamic view of relative economic and strategic power, and how best to shape and deploy economic power to achieve national interest objectives.

Yet very few countries think about policy interconnectedness in a strategic fashion. Indeed, very few countries could be said to do "joined-up" government at all well as there is a recurring lack of coordination between the strategic, military and economic institutions across nations. While it may be hard for any country to achieve this outcome, and perhaps harder still for democracies, history suggests that those which do can have a disproportionate influence at key times in history.

US ECONOMIC DIPLOMACY

The US has a long and enviable record of effective economic diplomacy – strategies that have effectively brought together economic, strategic and soft power in the face of key challenges. It has been, perhaps, less successful in

⁶ Nye, op cit, p4.

⁷ This stands in contrast to Mao-era China which had identifiable soft-power aims.

more “normal” periods – that is, where change is more gradual – in part, perhaps, because the stakes may be perceived as not as high.

Perhaps the pre-eminent example of joined up policy and the pursuit of economic diplomacy as part of a clear strategic agenda can be found in the Marshall Plan.

Equally, US leadership in creating the institutions that underpinned the post-war liberal economic order – the creation of the IMF, World Bank, GATT and WTO – helped underpin post-war growth, trade and investment, lifted hundreds of millions worldwide from poverty and delivered rising living standards to billions more.

More recently, US leadership in the establishment of the G20, with strong Canadian support, after the Asian financial crisis was recognition that the world had changed and that solving global problems required the involvement of a broader group of countries. The foresight embodied in that decisions turned out to be particularly important when collaborative responses were needed to the Global Financial Crisis (GFC).

But the question is not about the US’ track record. Rather, it is whether diplomacy in its current form will be as successful going forward, particularly in Asia.

The fact that Asia’s importance has risen, and will continue to do so over the decades ahead, owes much to the US’ underwriting of the liberal economic order. It is that regime of open markets, trade and investment flows, rules and effective institutions that contributed to the environment in which Asian economies have been able to grow and develop – from Japan to the Asian Tigers of South Korea, Taiwan, Hong Kong and Singapore, and now China, India, Indonesia and others.

And it has been US military primacy that has underpinned Asia’s fragile strategic balance.

Without both of these contributions, Asia's recent history and future promise would look much different. This should be acknowledged more often than it is.

But what is striking about post-war Asia was the absence until the 1980s of virtually any regional institutions to support economic growth and strategic stability.

By the late 1980s this was changing, with countries acceptance of the concept of an Asia region resulting in the institutionalisation of the reform processes and openness to trade and investment flows which had been fostered by the US and which had come to characterise Asia's post-war economic development. Geo-political change – the end of the Cold War – was a key factor, leading to ASEAN's expansion to cover all of South East Asia, and the broader embrace of regionalism.

The 1989 APEC initiative – led by Japan, Korea and Australia and designed to embed “open regionalism” – struggled to engage the US at the outset. The US only became fully engaged after active lobbying of President Clinton by Australian Prime Minister Paul Keating, who recognised that APEC couldn't succeed without the US, then Asia's largest trading partner. This engagement resulted in the first Leaders' meeting in Seattle in 1993.

The initial US ambivalence reflected disparate views within Washington as to the appropriate objective for APEC. “Community builders” saw it as fostering greater understanding and encouraging collaborative responses to issues in the region, helping countries become “normalised” to the idea of working together. As such, they took the view that the APEC project required patience and a long-term perspective. Others feared it was a vehicle to exclude the US from security and foreign policy discussions in the region and hence should be opposed, while a third group saw it predominantly as a vehicle to promote economic reform and trade liberalisation.⁸

⁸ For an elaboration on these viewpoints, see Charles E. Morrison, *Alternative American Perspectives on Asia-Pacific Regional Cooperation and the Future of APEC*, in *Kokusai Mondai (International Affairs)* No. 585, October 2009, accessed at http://www2.jiia.or.jp/kokusaimondai_archive/2000/2009-10_005e.pdf?noprint.

While ultimately the “community builders” prevailed, the tension between the manner of Asian multilateralism, with its focus on processes to deliver “behind the border” structural change, and the US’ more immediate focus on reciprocity, has been an ongoing source of friction within APEC. This can be seen in the approach to the 1994 Bogor Declaration aimed at achieving free trade among APEC members by 2020.

Moreover, even upon embracing APEC, the US has often looked to use economic fora to advance broader multilateral interests. For example, the expansion of APEC membership to include Russia, while probably desirable in the longer-run, added challenging complexity to a nascent institution and likely diminished its effectiveness for some period. The US also diluted the economic focus by broadening the agenda to include non-economic issues such as terrorism in the wake of 9/11. Each of these decisions seemed driven by US broader interests and short-term imperatives, not the long-term integration of the region. More recently, the same issues are presenting themselves in the G20 Leaders’ meetings.

But it was the handling of the Asian Crisis of 1997-98 which fundamentally changed Asia’s perception of itself and the nature of US-Asian economic relations.

The US, through the IMF, was perceived as both misreading the nature and causes of the crisis and then orchestrating a response which advanced its own political and economic interests. The IMF’s overloading of the reform agenda, arguably at the behest of the US, was seen throughout the region as ruthless exploitation of the crisis to push countries in particular directions they may otherwise have chosen not to pursue. While the region has conveniently chosen to overlook the culpability of the countries at the centre of the crisis, this perception of the US’ role is now deeply rooted in public and official consciousness.

This experience also directly resulted in the longer-term trend of Asia looking for new mechanisms for mutual support in order to reduce reliance on the IMF. This has not only damaged IMF credibility and effectiveness in the region, and arguably beyond, it directly triggered:

- the proposal for an Asian Monetary Fund, which was ultimately killed off by vehement US and Australian opposition;
- the establishment of the Chang Mai Initiative, which created a network of bilateral financing facilities and foreign currency swap arrangements; and, most damaging to growth prospects,
- a widespread prioritisation on building foreign exchange reserves as a (costly) form of insurance against refinancing risk.

Moreover, the region, at the time of the Asian crisis, contrasted US behaviour with that of China, concluding that China's decision to maintain the value of its currency at the height of the crisis and in the face of depreciation and devaluation elsewhere in the region, was a mark of leadership, notwithstanding that this was clearly in China's own narrow self-interest.

The recurring tension between the short-term outcome orientation of the US versus the focus on the building blocks of future cooperation was seen again in the context of the Manila Framework Group (MFG). The MFG emerged from the Asia Crisis as a mechanism to build confidence in macroeconomic coordination and operated successfully for several years until US reluctance to continue participation triggered its demise. It is an unfortunate reflection on regional inadequacies of the time that member countries couldn't countenance continuation of the MFG without US involvement. Again, the apparent US rationale was that the payoffs, as defined by (unspecified) concrete outcomes, were not obvious. In this regard, it echoed the initial disinterest in APEC and the ongoing frustration with its performance.

Such attitudes are, of course, never universally shared within any government, and senior Bush Administration officials privately described the decision to kill off the MFG as "one the US would eventually rue".

These three examples suggest that the US has not always understood Asian attraction to open-regionalism via a suite of institutions or how the region thinks about economic cooperation and coordination. An affinity for non-interference and relationship building deeply underpins Asian economic diplomacy. The US' default position of bilateral, rules-based, reciprocity, works well with many countries and in some regions, but has a more limited track

record of success in Asia.⁹ This is something that the US should keep in mind as it responds to China stepping up its role in Asia.

Yet the US has also shown great flexibility in other areas, such as its championing of the creation of the G20 to help strengthen crisis management efforts and the global financial architecture in the wake of the Asian crisis.

The 2011 pivot to Asia is a reflection of how core US interests are at stake with the transition of economic weight to the region, and to China in particular.

The pivot has embodied traditional elements of both economic diplomacy and military power in the pursuit of strategic objectives.

As part of this, the Trans-Pacific Partnership was an initially well considered initiative and, if successful, will deliver a strong benchmark for others to emulate. As such, it would be a visible sign of US leadership in the provision of global public goods. However, in practice, the US was arguably too obvious in terms of its strategic intent, vis-a-vis China, as a motivator for the TPP. Specifically, if true liberalisation is the aim it seems short-sighted to keep out the world's largest emerging economy from a core trading group, one in which it is the major trading partner of most if not all members. Moreover, it stands in sharp contrast to the approach taken by Asia toward involving the US in APEC.¹⁰

And whereas the US has prioritized the TPP, and its partner Trans-Atlantic Trade and Investment Partnership, China has put multilateralism and the WTO at the core of its approach to trade policy, an approach which appeals to much of the developing world and to the other EMEs.

⁹ The default for Great Powers tends to be toward bilateral dealings as they are more likely to prevail. In contrast, multilateralism tends to constrain their capacity to act. Recognising this highlights the enlightened nature of US statecraft in the aftermath of World War 2.

¹⁰ While the TPP is theoretically open to any country in the region, Wesley asserts that in reality the costs would be heavy for many developing countries. As a result, it's existence has spurred China's "One Belt, One Road" trade, investment and infrastructure initiative.

Looking back, it is hard to avoid the conclusion that overall US economic diplomacy has become increasingly more tactical rather than strategic. Far from the clarity of purpose and commitment that underpinned US leadership in the formation of global institutions – from the IMF and World Bank to the G20 – and their initial direction, US strategic intent has been increasingly difficult to discern. This can be seen repeatedly – from the failure to deliver on US-championed IMF quota reform to the response to the proposal to establish the Asian Infrastructure Investment Bank (AIIB), or the willingness to undermine US credibility with the pursuit of short-term domestic political agendas across multiple fora.

To some extent this echoes criticism of US diplomacy more broadly made by commentators such as Mead, Garfinkle and Haass.¹¹ What I conclude from their writings is that the collapse of the Soviet Union took away the **organising framework** for thinking about how to achieve US national interests and allowed the pursuit of short-term, single issues without any strategic connection.

The US' apparent focus on short-term expediency at the expense of longer-term goals around APEC, TPP and even officials-led fora like MFG, all raise questions about what has been, and what may become, the organising framework for US economic diplomacy in the region. This question becomes more important as it becomes harder to unilaterally determine the rules of the game – the costs of short-termism are rising.

¹¹ Walter Russell Mead, Adam Garfinkle and Richard N. Haass. Mead, for example, argues that “For a full generation we have not had to think too much about whether something done or undone in foreign policy promotes or endangers our vital interests and the security and prosperity of the American people”, arguing that the absence of serious strategic consequences to anything that happened in the immediate post-Cold War era resulted in issues being treated in isolation, without anyone ever having to “connect the dots”. [Mead, *The End of History Ends* in *The American Interest*, 2 December 2013.] Garfinkle suggests that the US grand strategy that prevailed till the end of the Cold War has been replaced by a sense of determinism that has resulted in the error quotient of US foreign policy rising, policy becoming largely reactive, and the US' reputation for consistency and competence suffering as a result. [Garfinkle, *The Silent Death of American Grand Strategy* in *American Review* No. 15, Feb-April 2014.] Haass has argued that foreign policy mistakes have hurt the US' reputation for competence, that US advantages are neither permanent or sufficient to ensure continued primacy without reform at home, and that “US foreign policy should focus not so much on what other countries are within their borders and more on what they do outside their borders.” [Haass, *Put America's House in Order*, in *American Review* No. 15, Feb-April 2014.]

This raises two intriguing questions. First, does China risk becoming a new organising principle for US policy if it pursues a determined strategy to displace the US as the pre-eminent power in the Indo-Pacific? Second, will the structural slowing in China's economic growth rates change perceptions about the speed of US relative decline? If so, it would be a clear case of economic outcomes with strategic consequences.

Far be it, though, for an Australian to criticise US diplomacy – Australia's recent history of economic diplomacy is, at best, a mixed bag.

As a small open economy, Australia has benefited from the US-led liberal international order. It was Australia's "mates" who wrote the rules and Australians have benefited from that – but increasingly it will not be the West holding the pen, so we also ask ourselves how should we respond?

Australia faces a reality different to many other countries. As the Secretary to Australia's Department of Foreign Affairs and Trade, Peter Varghese, has noted, Australia belongs to no natural global, regional or cultural grouping, and "cannot bully or buy its way in the world".¹² This has made us firm advocates of multilateralism alongside our bilateral relationships – indeed, both are "anchored in our national interests".

But Australia has also long recognised that our economic weight and influence in global fora are a direct consequence of what we do at home – that is, policy success begets both greater economic weight and global influence. But unlike the US, we lack what economists call "market power" – we are effectively a "price-taker" rather than a "price-setter" when it comes to global rules and institutions. Accordingly, we have a long history of trying to use our limited influence to strengthen existing global institutions, to the point that some might say we are annoying in pursuit of these goals.

¹² Peter Varghese, *The Challenges of Multilateralism*, Sir James Plimsoll Lecture, 7 November 2013. Available at <http://dfat.gov.au/news/speeches/Pages/sir-james-plimsoll-lecture.aspx>.

But, like the US, we haven't always been as strategic as we could have been in pursuit of our national interests – witness our strident opposition to the Asian Monetary Fund proposal, which damaged our credentials within the region for several years, and the opportunity missed to shape the AIIB with our initial rebuff of China, notwithstanding their genuine efforts to respond to our concerns.

On the other hand, successive Australian Governments have recognised the centrality of a successful and effective G20 to the pursuit of our national interests. We are only too aware that, were the G20 to fail, we may not have a seat at its successor. It is this realisation that underpins the extensive efforts we make in this fora, and especially during our Presidency in 2014.

CHALLENGES

While the collapse of the Soviet Union left the US the dominant power economically and militarily, that dominance of the last quarter century has come to an end, replaced by continuing US pre-eminence accompanied by the rise of other countries, each individually weaker on each dimension of power, yet able to stymie or challenge, although never displace, the US on different issues at different times.

As a result, we now have a world where no one country indisputably leads and this makes for a more fluid environment where regionalism and plural narratives are more likely to be the order of the day.¹³ This is a change in circumstances in terms of the breadth of issues, and the number of countries, able to constrain the US' capacity for unilateral action, or required to be "on-board" for effective multilateral responses to issues.

Arguably, the issues confronting the world – transnational threats like weak global growth, terrorism, pandemics and climate change – and the diffusion of power from nations to non-state actors, make multilateralism critical at a time

¹³ For a comprehensive discussion of this concept, see Amitav Acharya, *The End of American Order*, Polity Press, 2014.

when it appears in crisis. What is unclear is whether this crisis is transitory or permanent.¹⁴

While economic power has been multi-polar since well before the Global Financial Crisis, with the emergence of the European Union and the strength of Japan in the 1980s, the rise of multiple other countries, especially those that don't automatically share Western liberal values, creates greater complexity than that offered by either Japanese or European economic success, or indeed that when faced by one single rival in the Soviet Union. And while the transition of power among individual large nations is tricky, history can offer something of a guide. What is unknown is how best to manage the likely more difficult diffusion of power among multiple states and away from governments to non-state actors.

For the world, the US' role in galvanising institutions and groups of countries to address transnational challenges will remain crucial. How best to use US power to accomplish joint objectives, in circumstances where absence of support from other key countries will assure failure, is something that will only be determined over time. But what it will require is an agility in approach that can both embrace unilateralism on some issues while recognising the importance of multi-polarity and collective action on others. Again, to some extent this is not new – rather, it is that the balance of options is moving away from unilateral action and, hence, constraining the US' degrees of freedom to act, and raising the value of agility.

It will be an uncomfortable journey for all of us!

CHINA

It is clear that China has neither the capacity nor inclination to step forward, at this stage, as a consistent supplier of global public goods. However, while it is generally content to support the existing global institutions and rules, it clearly wants a greater role in being able to help shape governance arrangements, including through the creation of new institutions.

¹⁴ Varghese, op cit.

In the mid-2000s, then US Deputy Secretary of State Robert Zoellick couched the emerging situation as one where success would see China become a “responsible stakeholder”.¹⁵ While this concept garnered support in many circles, for emerging players it invoked the reaction of – “responsible” in the eyes of whom?

If it meant Chinese conformity to Western modes of behaviour and a passive agreement to rules and institutions created without its input, China was never likely to accept its role being defined in this way. And this was the case even as China recognised the importance of those rules and institutions for its own impressive economic development.

Indeed, how we respond to China’s rise will itself help shape China’s behaviour. A more realistic objective should, therefore, be to “shape the environment for China’s decisions”¹⁶ – and indeed, for the decisions by emerging economies more generally.

Chinese economic diplomacy has been remarkably deft in recent years, geared to its long-term objectives and clear in its support for open markets (especially in other countries) and strong multilateral institutions, even if its broader strategic impact has been undercut by fears of increasing militarization and regional assertiveness.

Some of this is clearly strategic positioning and in China’s own interests as the world’s largest trading nation. Some is clearly designed to reflect well on China’s model of growth in order to amplify its attraction to others (for example, exchange stability in the midst of crises, notwithstanding the recent devaluation). But some of it is also because China recognises it has been a beneficiary of the US-created global economic order and that the robustness and credibility of this regime is important to its own longer-term prosperity.

Equally, China is building a track record of effectively using various multilateral fora. In 2014 it successfully hosted APEC, working closely with Australia to ensure the APEC and G20 agendas were mutually reinforcing. On a number of occasions during Australia’s G20 host year, China was a critical and highly effective supporter for ambitious action.

¹⁵ *Whither China: From Membership to Responsibility*, Remarks to National Committee on US-China Relations, 21 September 2005. Available at <http://2001-2009.state.gov/s/d/former/zoellick/rem/53682.htm>

¹⁶ Nye, *op cit*, p 124.

Looking forward to 2016, China's hosting of the G20 will be a significant opportunity on a number of grounds. It will clearly invest in the G20 as a mechanism to build trust and better coordinate growth initiatives in the face of continuing weak global outcomes. It is also highly unlikely China will overload the agenda. Rather, it is likely to focus on delivering existing commitments and a small number of high impact key initiatives – given its own history, I anticipate a focus on development, outward-oriented growth and inclusive institutions.

Considered strategically, China's hosting also provides a significant opportunity for the US to work closely with it on issues of mutual importance – the question is whether the US is willing or able to take advantage of this opportunity.

That questioning of US willingness and ability may sound harsh but it reflects an increasingly strongly held view in parts of the region that, in recent times, the US has not displayed leadership on key economic issues other than bilateral ones – this is seen as reflecting an unwillingness to lead on some issues and ineffective attempts on other occasions because of an unwillingness to accept that the world has changed.

In particular, the US' often singular focus on global imbalances and exchange rate manipulation is widely seen as a reflection of domestic political imperatives. In part this seems to reflect a concern that the US cannot be expected to be the sole driver of global growth – but the reality is that this hasn't been the case for quite some time. Moreover, a continuing tendency to criticise Chinese exchange rate policies will challenge the abilities of the US and China to cooperate to ensure that minimal global dislocation results from China's impending capital account liberalization. This requires a huge transition in approach in both countries.

The critical point from all this is to acknowledge that most of the emerging and developing world does not share the West's "world view", and that changing economic weight makes it harder to ride roughshod over their objections to either the West's objectives or means of achieving those objectives. Carrying on business-as-usual in a world where others are able to effectively block what is desired is a recipe for frustration, disillusionment for all involved and risks further eroding support for multilateral responses to transnational issues, not to mention guaranteeing no actual progress on addressing issues of real importance.

Let me cite three examples of where US relative influence has been, or is at risk of being, damaged if current positions are maintained.

First, the failure of Congress to support IMF quota reform – something that comes at virtually no cost to the US and which has been championed by successive – Republican and Democrat – Administrations.

If we are to succeed in delivering the broad outcomes we seek, there needs to be a greater willingness to allow others to help shape situations and institutions. Notwithstanding the US efforts to drive reform in global institutions, supported by Australia, Canada and a few other like-minded countries, the degree of emerging market economy angst that global institutions have not reformed quickly enough to reflect their economic weight and that insufficient attention is given to their concerns is not well appreciated here. It is a key factor in emerging economies desire to consider alternative crisis management and financing arrangements, such as CMI, and new types of institutions, such as the AIIB and the BRICS bank.

If Congress fails to pass IMF quota reform it will create additional incentives to build institutions outside existing structures.

Second, US behaviour aimed at emasculating the establishment of the AIIB achieved two outcomes, neither in the US's long-term interest.

While a legitimate debate can be held about how best to support provision of infrastructure, the outcome was a widespread belief that the US is unwilling to acknowledge the real infrastructure needs of developing and emerging economies.

Moreover, by making the establishment of the AIIB a contest of wills between the US and China – which China won – the US elevated the issue from a useful contribution to the global institutional framework to an issue of global leadership. This was exacerbated by the anonymous spokesman for the White House whose “throwing the toys from the crib” response to the UK decision to join the AIIB alienated many.¹⁷

¹⁷ In a comment that harked back to British Prime Minister Neville Chamberlain's acquiescence to Hitler's territorial ambitions in 1938, the Financial Times of 12 May 2015 reported a White House official as criticizing the UK for “a trend to constant accommodation of China, which is not the best way to engage a rising power”.

Third, putting aside the economic merits of the TPP, failure to have it completed and enacted this year will damage significantly perceptions of the US' ability to deliver on its own initiatives – the consequences of such an outcome will be long-lasting and widespread. The value of a high quality TPP should be as a spur to drive domestic economic reform in member and other countries, not as a device to constrain emerging powers.

Taken together, these three experiences, and the need to help manage increasingly complex capital and exchange rate issues, suggests the US needs to be more sophisticated and nuanced in its economic diplomacy. At some stage, virtually all US Administrations are confronted with the limitations to their freedom to operate imposed by the structure and nature of the US political system. Sustaining US influence will, therefore, require the broader US polity to develop a more shared perspective on national interests, and how to achieve these internationally, over the decades ahead.

CONCLUSION

The world has changed and will continue to change as power transitions between nation states - changing the relative power balance – and diffuses across more countries and non-state actors. In a world of continuing fluidity, clarity of strategic objective will be critical to the pursuit of economic diplomacy.

While the changes discussed here are important, they are not existential for the US – US dominance is being replaced by US pre-eminence but it will remain critical to the world's capacity to act on global problems. The key challenge for the US will be how to frame its strategic objectives and economic diplomacy strategy for the long-term, and against a different backdrop to that of the last quarter-century. Importantly, the US has time to make these changes and to prepare itself for a more challenging environment in which to conduct its economic diplomacy.

For all countries a few key messages are common.

First, while non-state actors are increasing in importance and will complicate the pursuit of objectives in ways never previously seen, only nation states can negotiate and then deliver economic frameworks. However, how these outcomes are negotiated internationally, and then implemented domestically, need to change to reflect the changed realities of the 21st Century.

Second, policy success begins at home – delivering growth and economic outcomes that citizens value. It is domestic success which is the foundation for successful economic diplomacy. Good domestic outcomes both increase relative economic weight and create models to which others may aspire to emulate.

Third, it will be increasingly important to reflect on the skills and capabilities required by foreign ministries, treasuries and other economic institutions, if they are to produce the economic diplomats who can succeed in this new environment. Efforts will also be needed to ensure greater coordination among institutions in national capitals.

Finally, the world needs more combined US/Chinese leadership in shaping global institutions and addressing transnational issues. China, ultimately cannot avoid this responsibility but it will fall on the US to facilitate, and ultimately accommodate, this. As such, clarity of strategic objective and a flexible and adaptable style of leadership will be central.

US economic diplomacy in Asia since the 1990s has been characterised by periods of strong and effective leadership interspersed with periods of ambivalence and short sightedness. When the US was the world's indispensable power, such an approach carried limited costs for sustained US influence. That world, though, is rapidly receding.

Thank you.