Australia, Emerging Asia and Global Cooperation

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The emerging market economies have been powering global growth over the past quarter century, accounting for almost two-thirds of global growth as their share in world output collectively has overtaken that of North America and now Europe. On conservative emerging economy and bullish industrial country growth scenarios, Asian emerging economies are likely to account for a larger share of world output in purchasing power parity terms than all the G-7 economies combined in less than a decade.[1] Emerging economies—at least the ones in which most of the world's poor live—are catching up with the industrial world, big time.

Australia in Asia

Among all the OECD economies there is none that benefits more from emerging economy success—the primary locus of which continues to be in Asia—than Australia. Australia is the most Asia-oriented OECD economy in the world and there are few others, including other Asian economies outside the OECD, which out-rank it. Asia accounts for close to three-quarters of Australia's external markets, a larger share than that of Japan or Korea. Asia's continued growth through the global financial crisis, together with some deft domestic macroeconomic policy footwork, assisted Australia in maintaining its more than 23-year record of strong, uninterrupted growth.

Australia's external economic circumstance is the product of three main forces: the scale of Asia's growth; its relative proximity to these Asian centers of growth; and the deep complementarity of its resource endowment with that of its Asian resource-consuming partners.[2] For much of the commodity boom of the early 21st century, driven by the demand for raw materials associated with China's rapid heavy industrialization, the iron ore exporting state of Western Australia grew as fast, in some years faster, than the economy of China itself—in excess of 10 percent in real terms a year.

Now the party's over, and iron ore prices have fallen by upwards of 50 percent, the exchange rate has gradually retreated from a brief period of parity with the U.S. dollar, resource export volumes are up sharply and Australia's share in Chinese markets continues to expand, at the same time as Asia becomes Australia's outlet for more competitive services, agricultural and manufacturing exports. The debate about how everything has changed intensifies but nothing has changed in Australia's Asian external orientation; nor will it.[3] China is Australia's largest trading partner. It is too for 50 other countries around the world, with Australia's share among the largest. Australia has been the largest, and is still the second-largest, ultimate destination for Chinese direct investment abroad. China is also the largest source of overseas students (almost as many study in Australia as study in the United States) and a leading source of migration.

Together with India, Indonesia, Korea, Japan and ASEAN (by invitation), Australia and its Asian partners have a lot at stake in the G-20 process. Now that the immediate threat of the global financial crisis has receded, Asia's ambitions in the global community remain centered on economic and social transformation through sustainable development. This is an overriding social objective among the emerging economies of Asia and their closely interdependent neighbors. Being at the top table of global governance—participation in the G-20 process—is of importance first because it provides a forum for bringing to bear the instruments of international cooperation in trying to secure that objective.

Put simply, for these economies, the primary aim is to achieve their full economic and social potential for growth. The potential trajectory for growth is defined by where these countries start, what resources, capacities and technologies they are able to mobilize for growth domestically and through international exchange and knowledge of the experience of other countries in achieving economic and social transformation before them. A twin aim is to realize growth potential in a way that does not threaten economic stability of the international system—the preoccupations of crisis management in the early years of the G-20 summit. A corollary aim is to be accorded an appropriate role in shaping the institutions, rules and norms necessary to securing their accommodation and participation in an international system that is supportive of these aims.

On both fronts, the G-20 has a big and ongoing task and Asian G-20 members have a central role and interest.

Growth Potential

The good news is that, overall, the economies of Asia are a bull element in global recovery and long term development. The advanced countries, although less so now the U.S., remain a drag on the world economy, and there is no sign that Europe is likely to emerge from stagnation any time soon. Some argue that the European economies (and perhaps Japan) are doomed, through demographic and technological circumstance, to a long period of very low rates of growth, that their potential rate of growth is likely not much above their actual growth in recent times.

With the growth rates of emerging economies (not all of them, but overall) four to five times as high as those in Europe, they contribute the largest share to global growth. Even with convergence between the emerging economies in which most of the world's poor live and those economies that are home to the rich, there is the question of whether their current growth rates are near their potential rates of growth.

While China's growth rate may be close to its potential rate of growth, the structure of its growth is not sustainable and, for most of the developing world, including India, actual growth is way below potential.

Global growth between 2004 and 2007 was running at 5.1 percent, with growth over this period at 2.9 percent in advanced economies and 7.9 percent in emerging markets. This may have been close to or above the trend potential rate of growth. From 2011 to 2014, global growth was 3.4 percent, with growth of 1.6 percent in advanced industrial countries and 5.2 percent in emerging market economies. The IMF now forecasts global growth for 2014 at 3.3 percent, and growth for advanced economies of 1.8 percent and emerging economies of 4.6 percent and these forecasts continue to soften.

It is difficult to accept that rates of growth in advanced or emerging economies are near or nudging potential rates of growth. In Europe there are vast pools of unemployed labor, especially among the young. In emerging economies on the way through lower to higher middle income, and catching up with the industrial frontier, growth rates at 6 to 10 percent are the norm. As China moves to upper middle income, growth potential is easing back from 7 to 8 percent to 6 to 7 percent, and the trajectory is for growth a percentage point or so lower over the coming decade. India and Indonesia in the Asian region, and South Africa and Brazil outside, are languishing below their potential rates of growth.

Is the world condemned to a new normal of stagnation and low rates of economic growth?

Avoiding Stagnation and the Middle-income Trap

Growth potential, it should be noted, is not defined by laws of nature, alone or even largely. Growth potential is defined significantly by social and economic policy choices and by political will.

From this perspective, there is no inevitability that the advanced economies of Europe, North America and Japan (the old G-7) should be beset by long-term secular stagnation.[4] There has been no preoccupation with fear of long-term stagnation in Australia, a country favored by its geographic circumstance but also, importantly, by its earlier commitment to macroeconomic discipline and deep financial and structural reform. There are levers of macroeconomic policy that can be activated to lift effective demand; there are structural reforms that can unleash investment and productivity potential. Negative trends in these variables have more to do with policy failure than with chronic propensities to over-save or under-invest. In Europe and Japan achieving growth potential above recent low rates of growth entails hard social and political choices, and the prospect is for a long period of growth stagnation without such choices—in America, though there are similar choices, the constraints on growth potential appear less binding. Will the European or Japanese polities tolerate poor economic and social outcomes in the longer term in favor of easy options? It is possible, though there are signs (in parts of Europe and in Japan) that they will demand more.

In emerging economies, the hard choices are about the round of structural reforms that are needed to navigate the "middle-income trap."[5] The middle-income trap is an idea that derives from the experience of a host of emerging economies that looked as if they were on the road to high-income status but did not really make it. Growth rates petered out before they were able to progress from being a middle-income to a high-income country. Industrial "catch-up" might be difficult for many countries, but it is the easy part compared with effecting the transition from a per capita income of, say, $10,000 (Malaysia's per capita income in exchange rate converted terms or $15,000 in purchasing power parity terms) to one over $60,000 (Australia's). As economies become wealthier and the technology they need to apply more sophisticated, they lose the advantages of "starting from behind." They need to be capable of operating closer to the technological frontier and compete further up the value chain.

Governments in Asia will need to create an environment in which dynamism and investment will flourish, there is improved institutional performance and there is the required investment in human capital and infrastructure. Success or failure will determine whether strong growth in the region will continue over the longer haul.[6] But unless middle-income Asian countries take the long view and change course, they could fall, like many Latin American countries, into middle-income traps of their own making.

For India and Indonesia too perhaps, both at an earlier stage of development, the choices are more basic. There is still a way to go in lifting the shackles off trade, investment and labor markets to restore the momentum of outward-looking growth ignited by early stage reforms, and releasing the growth potential to absorb their rapidly growing young populations.

Cooperation on Growth

As Derviş and Kharas (Introduction) point out in this volume, in an open global economy, stronger rates of growth in the emerging economies, where returns on investment remain high, are consistent with higher net exports and capital flows from the industrial world to emerging economies on a mutually reinforcing path to higher global growth. Australia will bring its own structural reform program to the table in this income-boosting exercise, including a significant switch to productivity-enhancing infrastructure investment, encouraging greater workforce participation and reducing regulation and the costs of doing business. More expansionary policies and weaker exchange rates in advanced economies are a corollary part of the mix to bring global growth closer to 5 than 3 percent. These positive, mutually reinforcing trends will not be entrenched without international policy collaboration.

For making such collaboration possible, the composition of the G-20 itself is a vast improvement on the G-7.[7] Inclusion of the Asian and other emerging economies in the G-20 group is a major step forward. They deliver regional, cultural and institutional diversity as well as new economic power to the high table. Agreement may be more difficult, debates more intense, and disagreements out in the open. In global negotiations, though, it is more important to be talking to those with whom reaching some kind of agreement may be difficult rather than just with those among whom there is agreement to begin with. In that context, trying to exclude Russia from the Brisbane summit would have been very costly and unlikely to be possible without breaking the G-20 itself.

The main challenge for the G-20 now is to create sustainable world growth based on real investment that stimulates productivity gains and provides new, long-term jobs in the value-added chains of the products and services of the future across advanced and emerging economies alike. Laying the foundations for sustained global growth through productivity-enhancing reforms within the framework of a global income target is a plausible strategy for achieving this. So too is enabling productive investment in infrastructure.[8]

On the corollary objective of broadening participation in the established institutions of global governance, and ensuring that key global economic institutions are robust and able to withstand unexpected shocks if and when they occur, progress remains disappointing. Leaders need to add value, for example, by asking big questions about whether the global trade regime is headed in the right direction, or how to shape an international investment regime and what they will bring to dealing with climate change. These are vital issues for Australia and its Asian emerging country partners, although they are not prominent in the G-20 agenda.

The scale and structure of the global economy has changed dramatically since the post war institutions were put in place. The nature of international commerce and international capital movements and the presence of large new players like China, India and Brazil mean that the old rules need upgrading or extending. These are issues on which G-20 leaders and the Australian chair could give more strategic direction going forward from the Brisbane summit over the next three years.

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Endnotes

1. Australian Government (2012)
2. Armstrong (2013)
3. Westland (2014)
4. Vines (2014)
5. Drysdale (2013)
6. Kharas (2013)