

The Asian Century and the Global Response

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12 June 2013

Background

Australia has among the highest degrees of economic interdependence with Asian countries, which, given the scale of Asia's recent economic development, is to be expected given Australia's location and its resource endowment relative to Asia. This interdependence gives Australia a powerful interest in political and economic relations with Asia. Australia has steadily intensified its proactive economic and political diplomacy in Asia since the Second World War. Major initiatives through the 1980s saw the deepening of Australia's economic and political relations with Asia. But, until less than a decade ago, the China relationship could largely be managed within the framework of government-to-government relations. As with all Australia's relationships with Asia, that has changed profoundly. The relationship with China (which has become Australia's largest trading partner) and the rest of Asia now reaches into the community and demands political attention in a way that only recently wasn't the case. As the Prime Minister said when she launched the Asian Century White Paper, we are now in a space where we haven't been before in relation to Asia. What is true for Australia is true for many countries, including Asia itself.

As Australia's relations with Asia have developed and become more complex, demanding ever greater political and policy attention, there has also been a growing demand for public information and discussion of these relationships and how they are being managed. Our relationships with Asia now need to be talked about in the community, and need to engage and involve the community in ways they never previously have. This is what provided the impetus for commissioning the White Paper. The way it was set up was very unusual and engaged stakeholders and the community more broadly. The White Paper process is an ongoing project, which will extend over many years, to engage the wider community, in building capacities in government, the institutions, in business and more broadly. The document itself having been written, the challenge ahead is now to set up institutional processes to promote and facilitate wider engagement with Asia.

Session 1

The White Paper's time horizon is to assess changes in Asia to 2025. This recognises both that it is difficult to make accurate predictions over longer time horizons, and that many of the domestic economic changes, such as higher nominal exchange rates and unit labour costs, and the changes to the structure of the global economy and global politics associated with the Asian Century are already here. Geographically, it sought to avoid the tendency, present in much talk of the Asian Century, to focus too exclusively on China – indeed from Australia's perspective developments in South-East Asia and Indonesia specifically are also likely to be of great importance.

After studying the major economic, social, cultural and political trends to date, the White Paper set out to evaluate future risks and present strategies for Australia to manage them. The most important strategy for managing risks will be continued improvements to productivity and economic resilience or flexibility. This is already relevant, given the loss of competitiveness in certain sectors, and the likely increase in competition in services, where Australia currently has a strong comparative advantage, from increasingly middle-income countries such as China. Improving productivity will require realism about the fact that not all sectors can continue to thrive, and that some must be allowed to fold. The second strategy will be to improve the capacity of individuals, business, and the community to engage with Asia, which ties in with the fifth strategy, to see this engagement actually happen. Improving capacities will partly come from direct policy decisions, such as making sure that each child has the opportunity to study one of Indonesian, Mandarin, Hindi or Japanese. But it will also develop organically from the choices educational institutions, business and community leaders make and as migration flows from Asia continue to increase the diversity of Australian society, with multiculturalism increasing the exposure and Asian capabilities of all Australians. Already 30 per cent of Australians are overseas born, one third of that number from Asia. The third strategy will be for Australian business to more proactively form partnerships in Asia, dealing themselves into regional production networks, and will be supported by the target of having one third of board members with direct experience of Asia. The fourth strategy will be to minimise the security risks of the Asian Century. Though covered in greater detail in the second session, the view was here advanced that security for Asian countries, notably China, will be about secure access to water, energy, food, and a sustainable environment).

The forecasts of Asia's growth and change in the next decade or so in the White Paper, which are based on the correlation between institutional structure and productivity, show many Asian countries, including China and India, converging to middle-income per-capita GDPs by 2025, assuming their institutions remain substantively the same, with Asia making up 45 per cent of the world's output (at purchasing power parities). There are criticisms of these projections given that there is a low correlation between institutional structure and growth rates. But for a small economy like Australia, it is certain that Asia's growth will at least be of an order of magnitude large enough to radically alter Australia's economic ties and regional political arrangements. Indeed, this has largely already happened.

China's growth will be a large part of how the region performs overall. It is expected that an aggressive reform program will be announced before the end of the year, aiming to completely liberalise the capital account by 2020, and progressively internationalise the RMB. There was debate over whether the recent reductions in external and internal imbalances in Chinese growth were permanent, although it was argued that there is a consensus that consumption is underreported. Looking ahead, the effect of future Chinese productivity gains on the regional and global division of labour is not totally clear, but a most important and future trend will be the shrinking Chinese labour force. It will have effects on the structure of output, trade, and while there is certainly a risk that Chinese output growth will suffer, by how much and when slower cut cuts in remains to be seen.

The greatest potential break on the region's growth, the middle-income trap, weighs over the region. There appear to three areas where the region's countries'

performance needs to improve if they are to avoid falling into the trap. Firstly, vibrant and well-managed cities will be important. Currently, many large cities in the region are very poorly managed (witness Bangkok, Bombay or Jakarta), although Chinese cities do on the whole fare better. The worsening income distribution is the second risk to further growth. Skewed income distributions are clearly not a problem *per se*, as they can be the by-product of growth that raises living standards generally, and many in the region are more concerned with poverty-reduction than with keeping the distribution of income equal. But it is important that a country's institutions are consistent with a generally accepted view of what makes a fair society; this is arguably not currently the case in most of Asia. Thirdly, the growing complexity of higher-income economies raises the importance of reliable, predictable, decision-making and accountable and transparent governance. Decentralising decision-making, not just to lower administrative units, but more importantly to individual economic units, will be essential, yet few countries in the region currently meet this description.

Session 2

Economic trends considered in Session 1 have strategic and security consequences. In general there was a positive reception given to the White Paper's argument that security concerns would centre on water, energy, and food security, with the suggestion made that this list should logically include the effects of climate change. Yet these categories do not appear sufficient to explain the actions of China, and these are clearly not the only elements of security, but where they become existential questions, as for China and the Chinese government, they should be given much greater importance.

A central interest was the United States pivot (or rebalancing) towards Asia. Its major elements are first a more active participation in Asian regional institutions, second a reaffirmation of traditional alliances and a shift in military strategy towards an emphasis on air and sea power, third a more active promotion of trade liberalisation, fourth energetic diplomatic encouragement to Burmese reform, and fifth a continued search for a balance between engagement and hedging in relations with China.

Chinese criticism of the rebalancing as a form of containment is misdirected; China's neighbours have welcomed and encouraged the US as a counterweight to a growing and more assertive China, but do not wish to be made to choose between their economic interests and security concerns. The US does not have the same antagonistic relationship with China as it did with communist countries in the Cold War period; there are large bilateral trade, investment and human flows between the two countries, the US does not have any ideological opposition to China, and has long been an active supporter of Chinese growth and China taking on a more prominent international role, welcoming it into the WTO and voting to increase its voting power in the IMF.

The rebalancing could be seen as merely a commitment to continue providing regional public goods, like open sea-lanes. The current administration's approach to specific areas of conflict has been to treat them as individual test cases for relations with China. It has used them to try to build up a track record of collaborative

problem-solving with the Chinese and a commitment on their part to regional consensus-building organisations. Policy towards China is therefore clearly still evolving, but is encouragingly guided by a desire to engage the rising power.

The hardest component of the rebalancing to try to make sense of is the TPP. It is in part a reaction to perceptions that the US has been out of the game in Asia and needed to get back in. It was also presented as an attempt to take the lead in setting norms in the region, and there is definitely some competition in this area. Although it is hard not to see a trade agreement that excludes the region's most dynamic economy as something other than containment, as the Chinese have done, this is probably incorrect. There is even an emerging view in China that joining the TPP might help the government to push through domestic reforms, as joining the WTO did, though this view remains in the minority. In any event, the US should at least allow for the possibility that China will join the TPP; if it doesn't actively encourage it, a policy that actively excluded China could only be harmful.

There was a note of caution sounded against attempting to divine the future strategic environment. China's rise has certainly created anxiety among its neighbours, and it's difficult to predict how they will react if they feel increasingly threatened. Compounding this is a manifest desire to revisit the post-World War II settlement in Northeast Asia. Future developments in Asia are likely to be contingent on many simultaneous developments, with no clearly identifiable core trajectory. There is no guarantee that the current system of alliances won't change to better reflect economic relations, which would have further unpredictable consequences.

More attention should perhaps also be devoted to potential domestic limits to the rebalancing. These include the budget deficit, and the need to fix underperformance at home by improving school performance. Sustainable engagement with Asia will also require domestic debate in the US and an understanding of the importance of Asia, a discussion the White Paper fosters in Australia, but which has yet to start in the US. The lack of an obvious Asia person in the Administration compounds this problem.

Session 3

There are many global challenges that will require collective solutions. Climate change is the obvious candidate. Global efforts to agree to a course of action have so far been bedevilled by the exclusive search for a unanimous agreement between too large and diverse a group of countries, and by too narrow a focus on targets. An alternative approach might be to seek agreement on policy instruments rather than targets, or to focus on first securing agreement to limit stocks of carbon, and only after try to reduce them. International monetary system reform is another important problem. What are needed are concrete proposals for the future evolution of the international monetary system. One possibility would be for the SDR to play an increasingly important role in trade settlements, without replacing the dollar as such.

The international regime for collaborative problem-solving will need to evolve more rapidly than it has done to date, or risk irrelevance. The most significant effort so far to do this has been the elevation of the G20 to the level of a leaders' summit. But while there is plenty of good, technical work going on in the G20's work streams,

there is still a need for the leaders of the G20 to lead and develop a vision for both the future of global governance, and the path to be taken in addressing the substantive problems.

One international organisation where the challenge to reform or risk irrelevance is apparent is the World Bank. Emerging economies have tended to bypass the Bank, instead dealing directly with other recipient countries. Reforming the Bank will involve striking a balance between the older OECD members, and the newer members, bringing together new donors and the existing expertise of the Bank. Investment in infrastructure in Asia looks to be one area where both groups of countries have a common interest and there is scope to experiment and develop new financial vehicles that balance the interests of these two groups.

Ultimately though, much of the future evolution of the global architecture will depend on the role China takes. In its dealings with the international regime, China has in the past been more concerned with guarding its own sovereignty and presenting itself as the voice of the developing world. There has since been some movement in China to push for more reform of the international architecture, but the single most important characteristic of China's engagement with the international regime today is the diversity of views, between officials, scholars and the public, that exists within China on just what China's role should be. This diversity in turn reflects different views about China's place in the world: is it a developing economy, an emerging economy, a global power or even an equal superpower?

Notwithstanding the current differences within China about the country's capacity to shape the global architecture, the real question is not if but when China will feel able to take on a leading role in the shaping the international architecture. How then will China and the US interact on global issues? Should they attempt to find common ground between themselves first, before badgering other countries into line? Will China push for separate spheres of influence for the two countries, a tendency that can already be observed today? And what will be the role of middle powers, which represent far more than just their own interests, and tend to take a pragmatic approach to solving collective problems, be in this evolving architecture? An optimistic view of the future might be that the G20 will provide a forum for the formation of different coalitions on different issues, avoiding the formation of blocs, with middle-powers mediating the different rivalries between the major powers. The G20 is still under trial but in this context is of deep strategic interest to countries like Australia in managing the major problems and risk of the Asian century.