

DIALOGUE WITH MARTIN PARKINSON

“NAVIGATING THE TURMOIL”

Hosted by Caixin Media

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Introduction

Distinguished guests, ladies and gentlemen.

It is my great pleasure to be here in China. While this is my ninth visit to China, it is my first as Secretary of the Australian Treasury. And I have arrived at an exciting time. With the China-Australia relationship developing apace, this will certainly not be my last visit.

I thank Caixin for organising today's seminar on "Navigating the Turmoil" and change facing the global economy.

First, we face turmoil and risk from the sovereign debt and financial system crises wracking the North Atlantic economies.

But change akin to the shifts of tectonic plates is also underway across the globe. The world is working through a once-in-a-century shift in economic weight and political influence, triggered by the re-engagement with the global economy of around 1/3 of the world's population, with the development of China and India.

And the transformation does not end at Asia's edge. We see a similar story developing in other emerging economies. For example, a young population and improvements in human capital will likely contribute to an expected doubling in South Africa's GDP in the next twenty years while Nigeria's GDP is expected to increase three-fold to displace South Africa as the continent's largest economy by the late 2020s. Latin America also continues to surge forward with Brazil and Chile leading the way — with both expected to double in size by 2030.

Even in Asia, the transformation is not solely a China and India story — Indonesia, Vietnam and other countries in our region are developing rapidly.

But while growth and transformation is underway in a range of key emerging economies, the greatest concentration of change is here in Asia. Australia's future is inextricably intertwined with the success of our region.

It is for this reason Australia's Prime Minister, the Hon Julia Gillard, has initiated the preparation of a White Paper on Australia in the Asian Century, with work to be led by my predecessor, Dr Ken Henry.

Both the shorter-term North Atlantic crises and the longer-term economic and political transformation bring into sharp relief the need for strong global governance.

Global economic governance is an issue in which I have taken a close personal interest over many years. In my various roles at the Treasury, and during my time working at the IMF, I have had direct exposure to the workings of the international economic institutions. This has left me with a number of impressions which I would like to share with you today.

The current turmoil¹

There has never been a more pressing time to think about global governance. The global economy continues to follow a bumpy road, with new surprises occurring with ever increasing rapidity and, I fear, a pervading sense of crisis will be with us for some time.

The unfolding and depressing saga of the European sovereign debt crisis sees events change on a daily (if not hourly) basis, and events in recent days have taken the world into an even more dangerous place. It's not just events in

¹ This material draws upon my presentation entitled "Policy Challenges in a Changing World", delivered to the American Chamber of Commerce in Australia on Wednesday 9 November 2011 in Melbourne.

Europe either, with the unprecedented downgrade by Standard & Poor's of their US sovereign credit rating in August providing yet another twist.

The proximate causes of the current situation in Europe are well known – unsustainable sovereign debt positions among some euro area economies has led to questioning of policy response and fears of contagion throughout Europe and beyond. The growing recognition that recoveries in both the US and Europe will be weaker than previously expected has made the task of winding down excessive debt levels look even more intractable.

Uncertainty and risk aversion associated with global growth concerns and the European sovereign debt crisis have gripped financial markets. Volatility has become the new norm.

Across the Atlantic, growth in the United States weakened significantly in the first half of 2011. While it has strengthened somewhat since, the US recovery remains vulnerable to external shocks such as a re-intensification of the European sovereign debt crisis.

And if too many countries pursue contractionary fiscal consolidation without sufficient focus on growth enhancing policies, we risk stagnation in large sections of the advanced economies.

As my colleague, Mike Callaghan, has said today in Sydney, the “prudent thing is to prepare for a rather rocky international economic picture”, a situation that will prevail for some time.²

² Address by Mike Callaghan, Executive Director (International), Australian Treasury, to the Australia-Japan Outlook Conference, 24 November 2011.

The need for global governance

There is no doubt in my mind that a well functioning system of global economic governance is essential to responding to the sort of turmoil we currently face in the world economy. The wellbeing of citizens of our individual economies depends upon it.

National economies are becoming increasingly integrated. Prices are increasingly set in global markets. Mobile global capital ensures that investment returns in one country cannot be independent of returns elsewhere.

These linkages bring enormous economic benefits and raise global wellbeing. But they also create a need to avoid spillovers that are destabilising to the system as a whole. There is no escaping the fact that one nation's trade or capital account surplus is another nation's deficit. Distortions in one economy can be transmitted to other economies.

This has never been more clear than it is today. We live in a world where instability in a country as small as Greece, which accounts for about ½ a per cent of world GDP, has sent waves of disruption through its near neighbours and ripples through the entire global financial system.

The role of institutions

Increasing global integration has created a need for a system of governance to help ensure stability.

Ever since countries began to trade across borders, there has been some form of agreement between nations, tacit or otherwise, about the workings of the international monetary system.

The simplest form of 'international monetary system' was the gold standard, under which gold was used as a common means of exchange and standard of

value. Different types of gold standard were around from ancient times until late in the last century.

We have seen multiple attempts to improve global coordination through the 20th Century and into the present century. This has seen the development of the Bretton Woods system in the 1940s, the establishment of the WTO in the 1990s and the formation of the G7, the G8 and, most recently, the G20.

While the Bretton Woods institutions have always included representation from most countries in the world, and have tried to operate on consensus lines, they have historically been dominated by US and European interests, that is, by the historic providers of funding to the institutions

When the G7 was formed in 1975 to promote further international cooperation, it comprised the existing economic powers of North America and Europe.

But the rise of China and other emerging economies, and their further integration into the global economy, has brought us into a new phase of global governance. It has called into question the relevance of institutions that do not adequately reflect the increasing economic weight of the emerging economies.

Australia has been an early advocate of a system of global governance that better reflects the economic importance of developing Asia. For more than a decade, we have advocated for greater representation of emerging markets and developing countries at the Bretton Woods institutions and for the more representative G20 to play a more central role in global economic governance.

Indeed, in the IMF and World Bank we have deliberately moved from a situation of Australian leadership of our constituency – itself a blend of developed and developing economies – to a situation of partnership with South Korea, sharing equally in the Executive Director position.

And in the UN Intergovernmental Panel on Climate Change, Indonesia and Australia have put joint policy positions - the first time a developed and developing economy have done this.

This modus operandi, though, has been common to the G20 since its inception as a Finance Minister's process in 1999 and was maintained with the move to a Leaders' process.

The G20 brings together the key emerging and advanced economies to work together on key global issues. Through the advocacy of countries like Australia and China, the G20 now plays a more central role in a wide range of issues. And because of the efforts of some G20 members, including our two countries, reforms are now under way at the IMF and World Bank to increase the voice and representations of emerging economies.

These are important reforms that will bolster the legitimacy of these institutions and of the global governance framework.

This is an important step forward, but is only a first step.

The role of Asia

With increased economic weight and representation for emerging economies comes increased responsibility. That is, responsibility to help deliver global public goods such as ensuring the international institutions are effective in providing stability to the global economy.

It is no longer possible for the US and Europe to steer the world economy when they are no longer the main engines of global growth. Decisions about the global economy made in Washington, London or Paris that do not take account of developments in this region are doomed to failure.

This puts China in an important but difficult position. By virtue of its sheer size, no major global public policy issue will be capable of resolution without China. But if China does not step up to help, the world will not be able to resolve the problems, making for a more difficult world in which China has to manage its own development. Put differently, China has to contribute to the provision of these global public goods to help smooth its own development pathway.

I know that China often feels that expectations may have moved too far. That too much of the weight of global adjustment is expected of China and other large developing countries.

Australia understands this concern, and appreciates that China faces significant domestic policy challenges. Its GDP per capita has grown by a factor of 15 in the past three decades and it is now the world's second largest economy. But China still ranks only 94th in the world in terms of GDP per capita. It has a lot of catching up to do.

To keep its growth model sustainable in the longer term China faces a huge domestic reform agenda. All of you here will be very familiar with these challenges. You recognise the need to rebalance growth toward consumption to deliver a better quality of life for your citizens and to reduce reliance on exports as a source of growth. In 1980, investment accounted for around 35 per cent of Chinese GDP, and private consumption around 50 per cent. By 2010, these numbers had effectively swapped: consumption 34 per cent of GDP, investment 49 per cent. No other successful economy has been so reliant on exports and investment to drive growth.

You are also acutely aware of the need to address sustainability issues, such as growing income inequality, environmental degradation and the threat of global

climate change. And you face an ageing population and will soon also face a declining workforce.

These domestic issues will present challenges for all arms of economic policy, be it fiscal or monetary policy, social security and financial sector reform or agricultural land reform. Australia has been through its own reform processes in these areas and understands the scale of the task.

Our experience of the 1950s through to the 1970s drove home to us the critical role of liberalising prices throughout the economy – product prices, labour prices, financial prices and the exchange rate – in order to improve the allocation of resources and deliver sustainable improvements in living standards. China is no different.

It took us 30 years to learn our economic model was unsustainable but we were a small part of the global economy. Our reforms commenced in the 1980s and have delivered huge benefits to our citizens.

China's reforms have been underway for just as long, and much more remains to be done. China may well argue that the rest of the world can't expect a country facing such a formidable domestic agenda to solve the world's problems as well.

And the world's problems are not small.

Most of the world's largest economies are facing unprecedented domestic challenges. The danger is that countries turn inward and pursue protectionist strategies at a time when the need for global cooperation has never been greater.

We can't expect countries to turn away from their domestic agendas. But there must be recognition that international cooperation is an important part of

solving domestic problems in a world where individual economies are increasingly integrated through trade and investment linkages.

Any country that fails to recognise that risks unwittingly encouraging protectionist strategies elsewhere, to everyone's detriment. I believe China knows this, and the importance of global cooperation to solve our shared problems.

Moving in the right direction

The emergence of the G20 at Leaders' level has been crucial in providing a high level forum through which the major economies cooperate to address global challenges. Importantly, it brings together the major advanced and emerging economies into an effective forum.

And I am encouraged by how China has embraced the G20 as the premier forum for global economic cooperation. The G20 is specifically mentioned in the 12th Five Year Plan – a sign that China recognises the importance of global cooperation in framing its domestic policy agenda.

This is not a new development. China successfully hosted the G20 Finance Ministers meetings back in 2005, and made a welcome contribution when Australia hosted in 2006. Our two countries have continued to work cooperatively through the G20 and other international forums for a long time.

In my opinion the G20 is the right forum to address global economic challenges and there is commitment from the major economic powers to make it work.

But we are in a very challenging time for the global economy, which will test the leadership of the G20 and the resolve of its members.

It is now clear that the economic challenges in the US and Europe are not just cyclical but reflect deep-seated structural problems. It is not a matter of waiting

out the cycle, but making difficult policy choices that address these structural problems.

Developing countries have significant opportunities but face a different set of structural challenges to maintain the momentum of growth.

And interactions between the advanced economies and the emerging economies will add a new dimension to this adjustment process.

The G20 therefore has a big agenda.

The most immediate need, as emphasised at the G20 Summit in Cannes, is for a comprehensive response from Europe to deal with its sovereign debt crisis to avoid further contagion. Part of this will depend on the success of the European Financial Stability Facility, but also ensuring that the IMF is adequately resourced to respond to the needs of all its members. And any IMF financing must also be accompanied by appropriate conditions to ensure that necessary reforms are taken.

The plan to address the immediate crisis should be supported by reforms to lift growth and create jobs – including a commitment to boost domestic demand in emerging economies through enhanced exchange rate flexibility.

We must be ambitious about the G20's agenda but also realistic. We cannot expect the G20 to transform the global economy in one summit.

But any institution only retains legitimacy through success. The G20 and the international community needs to continue to show that it has the resolve to meet the challenges we confront together.

Conclusion

China and Australia have a shared interest in ensuring a well functioning system of global governance that reflects the growing economic weight of this region.

As Australia looks to 2014, when we will host the G20 Summit, we will continue to look to China for its support in ensuring the G20 is successful in addressing the significant challenges in the global economy.

Thank you for your time this morning and I look forward to your questions and comments.