

INTERNATIONAL ECONOMIC COOPERATION – IS IT AT RISK?

Speech to the Centre for Strategic and International Studies

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Introduction

It's a privilege for me to address you this evening.

I would like to commend the Centre for its Pacific Partners Initiative. It's a great way to bring Australians and Americans together to speak on issues of mutual interest for our two countries.

I notice in the past six months alone you've hosted the Australian Foreign Minister—Ms Julie Bishop—twice, the Australian Minister of Communications, Mr Malcolm Turnbull, and Australia's G20 Sherpa, Dr Heather Smith. The high profile of these speakers reflects the high regard in which the Centre is held in Australian policy circles.

Ms Bishop has already spoken to you about the importance of US-Australia relations. So I would like to speak about a broader topic—the challenge to international economic cooperation, and its underpinning global architecture, in today's increasingly plurilateral world.

It may be considered unusual for a Treasury Secretary to present on a topic more commonly reserved for foreign affairs officials. In fact as my friend, the Secretary of the Australian Department of Foreign Affairs and Trade, Mr Peter Varghese, recently remarked: “it's a most dangerous situation—a Treasury Secretary with a worldview—and one not to be encouraged”. But jokes aside, these are not issues that can or should be ignored by domestic economic policymakers.

The global economic backdrop is changing. These changes inevitably have implications for the global environment and architecture in which international economic cooperation occurs and hence on how we consider domestic policy choices.

Changing Global Economic Fundamentals

I would like to begin by briefly identifying four key pillars behind the current global economic reshaping.

The first is the advance of technology.

The Industrial Revolution broke the link between the size of a country's population and its ability to project economic might on the global stage. Advances in technology that occurred in Britain and Europe allowed a relatively small part of the world's population to wield outsized influence.

Today, the much wider dispersion of cutting-edge technology and productivity advancing processes is leading to a return to the pre-Industrial Revolution paradigm, where the size of a country's population is itself a driver of geoeconomic and geopolitical importance.

Technology in the hands of many is restoring the link between population and influence that was broken by technology in the hands of a few.

While the developed world in many ways still has an absolute technological supremacy, the democratisation of technology is helping facilitate the rise of the emerging world.

With this return to the pre-Industrial Revolution paradigm, population and demographics—the second pillar—become increasingly important. This matters a lot to the developed world because we're characterised by an ageing, educated workforce and more or less stable populations.

For developed countries, our ageing populations will detract from future growth, and the ageing of the median voter may inhibit willingness to embrace structural reform. In contrast, the demography of many—but not all, China being a prime example—emerging economies will, by and large, accelerate their development.

In fact, in some instances, population is magnifying the effects of the first pillar as the dynamism and innovation engendered by large and increasingly better educated populations

provide emerging economies greater opportunity to take the lead in technological advancements.

The third pillar is sustainability. Partly due to climate change, we're seeing a change in the distribution and relative importance of resource endowments worldwide. With that comes new opportunities for conflict or cooperation, for example over food, water and energy security.

As the implications of climate change become clearer to countries, it will be increasingly important to integrate climate change mitigation strategies and energy security policy into broader foreign and economic policies. Diversification into alternative energy sources will become more attractive and given the importance of energy—and who controls it—this kind of democratisation of energy will change geopolitical and geoeconomic dynamics.

The intersection between the democratisation of technology, changing demographics, and the growing importance of resource sustainability comes together in the fourth pillar—the shift in the global economic centre of power.

The centre of economic gravity, which had been shifting from Asia to the West since the Industrial Revolution, is now returning to the Asia-Pacific. In the case of China, its embrace of market forces has unleashed the economic potential of its large population, and that transformation is far from finished. In the thirty years since reforms began, China's share of world output has increased almost eight-fold, while the size of the world economy has itself increased five-fold.

The economic growth experienced in Asia will also generate sustained growth in average incomes in these countries, reinforcing aggregate growth. It will continue to lift millions out of poverty and millions more into a growing Asian middle class. Based on plausible projections, by 2030 the Asian middle class could expand to around 3.2 billion people—more than the rest of the world's middle classes combined, and up from half a billion in 2009. By 2050, four of the five largest economies in the world are projected to be in Asia—China, India, Indonesia and Japan.

But it's not just a story of a *shift* in the global economic centre of power from the Atlantic to Asia; it's also one of *dispersion*. The world where there was a clear single centre has

changed. In addition to the Atlantic and Asian centres, lesser but still influential “hubs” are emerging, such as in Latin America.

In 1950, emerging and developing economies represented three-quarters of the world’s population and a third of global GDP. Today, emerging and developing economies account for 85 per cent of the global population and 50 per cent of GDP.

Before I continue, I’d like to note an important caveat to this. The drivers I’ve outlined here project a convergence of emerging with developed economies—however, this is potential, not preordained, change. For this potential to be converted into outcomes requires good policies, sound institutions, and the conventional facilitators of growth.

The “demographic dividend” faced in countries like India and Indonesia is a good example. We have seen in North Africa and the Middle East the double-edged sword that a large, young population can present. If a country’s economic institutions cannot generate strong and sustainable job growth, the prospective “dividend” can quickly become, as some put it, a time bomb.

Similarly, if institutional arrangements don’t ensure economic growth is reflected in the overall living-standard improvements expected by the lower and middle classes, as their expectations adjust to being global citizens, this can further destabilise growth and derail potential. Emerging economies cannot be complacent.

Implications for International Economic Cooperation

Given these changing global fundamentals, what are the implications for international cooperation and the global architecture?

First and foremost, despite the changing shape of global influence—and even *because* of it—the need for economic cooperation and collaboration between countries is vital.

Today, the intricate networks of trade, finance, people, and confidence channels that link us all have created a world where a country’s economic circumstances and policies don’t simply affect itself. It’s not necessary to cite examples in support of this as the years since the onset of the global financial crisis have brought this starkly into conventional wisdom, if it wasn’t there previously.

In such a world, international cooperation is essential. It's important that countries identify commonality of interests, taking action to mitigate negative spill-overs and recognising the potential benefits of collective action to provide global public goods. Comparing the inter-war period with the post-World War II era, the lesson is that global growth and stability requires this co-ordination, and it's truer now than ever.

However, while the importance of international cooperation remains unquestioned, the changing backdrop *is* presenting challenges to the global architecture. The global architecture was set up under a Trans-Atlantic hegemony. As the hegemonic status has changed, the system has become strained, and the inability to adjust is resulting in growing fragmentation. The very use of the word "architecture"—implying a relatively fixed, well-designed, and uniformly accepted set of global institutions and conventions—is, arguably, increasingly misleading.

One factor challenging the architecture is the simple fact that global power is shifting and dispersing. As power spreads across multiple centres and hubs, new institutions naturally spring up to represent them.

Also, what we're seeing is that these centres are themselves more heterogeneous groupings than previously. Asia is a case in point. The Asia-Pacific region represents an area of more divergent interests, values, cultures and histories than, for example, Europe or North America. This diversity can naturally engender multiple forums to reflect it.

A second factor challenging the global architecture is the faltering progress being made to reform the traditional global institutions.

The emergence of multiple centres with stronger and more divergent voices is both a cause of, and a response to, this faltering progress. Common endorsement can no longer be achieved simply through shared interests and values of a small number of countries. Emerging powers are increasingly unwilling to accept outcomes from processes in which they have not been meaningful participants, and they do not necessarily share the core values and interests of the traditional players.

But this faltering progress is also partly due to hesitancy from the larger players to commit to taking the lead to make global cooperation successful.

Here in the US, the belief that global multilateralism is in America's best interests is arguably being increasingly questioned. Indeed, as Richard Haass has noted, the US has two co-existing but contrary inclinations: "to try to do too much and too little" in foreign policy¹.

This is not restricted to foreign policy. Moreover, as Haass also notes: "American political dysfunction... is getting in the way of the US restoring the foundations of its power and doing what it can and should do to make sure that the economic foundations of all that [it does]... in the world are secure". The unwillingness of Congress to progress IMF reforms is a striking example of Haass' thesis.

At the other end of the Trans-Atlantic axis, Europe is characterised by introspection as countries struggle to come to grips with the aftermath of the global financial crisis, the failure in many countries to progress structural reforms after the creation of the euro, and the consequences of an ageing population. This introspection, combined with the failure of US leadership, allows those European countries opposed to modernizing the global architecture, to avoid facing today's economic and strategic realities.

Meanwhile the emerging powers are still only taking tentative steps towards a leadership role in providing global public goods. Despite their desire to exercise influence, they've so far been conservative in what they bring to the table, with agendas that are relatively inward-looking, due partly to challenges some face in transitioning from emerging to advanced status. This hesitance is making it easier for others to leave the architecture unchanged at little short-term political cost.

To the extent these actions are generating complacency, about the sustainability of the current architecture, that complacency is seriously misplaced.

The growing number of voices and the absence of meaningful progress at the global level are resulting in a preference for issues to be addressed in sub-global forums. This is taking a number of forms.

¹ Haass, R. *'The Post-Cold War World 25 Years On'*. Speech to the Council of Councils Regional Conference, 23-25 February 2014

As the most obvious form, regional multilateral groupings are common. These groupings, with more formal institutional structures, processes and membership, to some extent replicate the structures at the global level, but with fewer voices around the table and more commonality between members.

What we're also seeing is a range of less formal arrangements, sometimes described as "softer" governance and coordination.

One approach is the creation of issue- or context-specific plurilateral groupings with constrained membership based on shared interests and a predisposition to work together. Formal and legal requirements may still exist, but the key is that their commitment and shared interests allow faster progress on an issue or initiative, sometimes on the basis that the final agreement is open to others to join at a later date.

Another trend is towards plurilateral groupings based on voluntary participation and without strong *ex ante* expectations of outcomes or initiatives. These groupings are designed more to facilitate the exchange of views and dialogue, and create a stronger, more coordinated voice in larger forums. Where necessary, they rely primarily on "peer pressure" to achieve outcomes.

The result of all this is the emergence of a large, loose and evolving web of overlapping forums, institutions, and arrangements—each with a slightly different emphasis and key players—that sits both below and within the global architecture.

Engagement and Leadership in a Plurilateral World

So, in this world, is economic cooperation at risk? And if so, how do we ensure it continues meaningfully?

Firstly, I want to make clear that I still believe that global multilateralism delivers benefits that cannot be achieved through a network of bilateral, plurilateral, and regional arrangements.

While its ability to address new issues may be facing challenges, the existing architecture of global institutions, forums and agreements provides a stock of rules and standards that still underpin international behaviour, including in the sub-global forums.

Also, given the global interconnectedness I described earlier, it's vital we retain effective *global* economic dialogue that recognises the spill-overs—both positive and negative—that stretch so prevalently across today's world. This includes the need for global cooperation to address challenges that, in terms of their nature and potential impacts, are truly global.

To paraphrase Richard Haass again, the world faces a number of global challenges—climate change for example—where there is a significant gap between the scale and nature of the challenge and the scale and nature of the global consensus and arrangements in place to manage it. Closing this gap through effective global cooperation is the only way to address these global challenges.

That said, I caution against the temptation to try to insert every major global issue into those forums that work reasonably well. This is almost certainly a recipe to undermine what is actually effective. Instead, if subject specific forums—such as the World Trade Organisation or United Nations Framework Convention on Climate Change—are not delivering, a key focus of effort should be renovating those bodies to make them more useful.

It's also important to note that the current architecture reflects, at its core, a set of values for which the traditional powers stand. While some argue this is part of the issue, these countries ought to see that it's in their interest to retain these institutions that are best able to build on those values—although when I say “retain”, they also need to adapt to the new global backdrop and ensure they are fit for purpose. Without adaptation and evolution, retention of those institutions will not equate to retention of their existing capabilities!

A recent model for global cooperation in which Australia sees significant merits is the G20.

The G20 represents around 85 per cent of the world economy, 75 per cent of global trade and two thirds of foreign direct investment, so it's naturally well-placed to be a key global economic policy-making body. However, its strengths are broader. Its representation is designed to be regionally balanced and reflective of the global economy, while its less formal structure allows both flexibility and frankness in discussions.

We have seen the strength of the G20 through the global financial crisis. As bad as it was, the crisis could have been much worse if not for the leadership and actions taken by the G20, which moved quickly to help stabilise financial markets and support the global recovery.

And following the crisis, the G20 remains relevant. It has continued to press for domestic policy shifts from members, such as euro-area structural reform and the easing of austerity measures, and renminbi appreciation. And, as is being seen with the crisis in Ukraine, the G20 recognises that countries will need IMF support at critical junctures. It was the G20 that pushed for a substantial increase in the IMF's resourcing to ensure a strong global safety net exists, and for reforms to IMF governance to ensure ongoing legitimacy and credibility.

In saying this, it's important to acknowledge that the G20 has its own shortcomings.

One criticism levelled at the G20 in recent times is that it has become less effective as its agenda has become broad and unwieldy. Australia is acutely aware of this and in our presidency year we are running a tight agenda focused on promoting private-sector-led growth and building global resilience.

We fully expected, and are seeing, pushback on our attempts to narrow and focus the agenda. We will, however, maintain the discipline we think is necessary for the G20 to function effectively and deliver in those areas where it can best make a real difference. In short, under Australia's presidency, "forum shopping" and efforts to bring other issues into the G20 will be strongly resisted.

In the same vein, the quality of debate and interaction among ministers has been characterised as less robust than in the past, leading to less effective policy outcomes. To address this, Australia has introduced innovations to the G20 meeting format to facilitate genuine debate on policy issues – in short, to allow Leaders to be Leaders.

Given its depth and reach, the G20 has an important role to play in steering the global economy, and Australia is committed to securing it as the key international economic governance institution.

However, despite the importance of global forums, we also have to accept the world we're living in: one in which the emerging importance of an ever-growing network of sub-global engagement is unlikely to reverse. As such, countries need to be creative and flexible in how they balance their commitments and interests to ensure they engage meaningfully across these sub-global forums.

This engagement is important – countries need to remain involved in cross-border issues and policy initiatives that are increasingly addressed at the sub-global level.

It's also important for the respective forums themselves. The trend towards regional and plurilateral engagement risks undermining international cooperation, potentially engendering regionalism and nationalism that could inhibit global efforts. But at the same time, it can also *support* international cooperation.

To achieve the latter, we need to ensure that global and sub-global forums coordinate and maintain linkages across the web of interconnections I noted earlier. If countries engage effectively across these forums, overlapping membership is one way to help ensure consistency across frameworks, and thus ensure that sub-global efforts strengthen and complement—rather than undermine—global efforts.

Plurilateralism in the Asia-Pacific

Before finishing, I'd like to briefly focus on the Asia-Pacific. As an area not traditionally heavily involved in the global institutions, and one with disparate interests, values and cultures, the Asia-Pacific is a region where this regional and plurilateral engagement is especially important. As such it provides a good example of the sub-global network I have just described.

The Asia-Pacific's network of forums and arrangements for economic and financial cooperation has grown significantly over recent decades. This has been spurred by the broader global economic fundamentals I outlined earlier, as well as region-specific factors like the financial volatility experienced during the Asian and global financial crises, a growing sense of common opportunity in the “Asian Century”, and a response to the shifting power relativities that are evolving quickly and significantly.

Achieving cooperation in this environment—particularly cooperation that complements global efforts—is challenging, but possible.

Regional forums, such as the Asia-Pacific Economic Cooperation (APEC), the East-Asia Summit (EAS), and the Association of Southeast Asian Nations (ASEAN), provide established vehicles for region-wide cooperation. APEC's institution of voluntary commitments, without binding agreements, has provided a solid basis for collaboration and

dialogue, and made progress in areas where difficulties with formal treaty ratification may otherwise, as in the US, have presented hurdles. Meanwhile, ASEAN has strongly encouraged its members to recognise their commonality of interests and strengthen their voice in larger forums.

Plurilateral arrangements have also resulted in cooperation where, arguably, progress wouldn't have occurred through traditional vehicles. For example, voluntary initiatives like the Trans-Pacific Partnership free-trade agreement and the Asia Region Funds Passport—an initiative aimed at facilitating cross-border recognition of mutual funds products—were driven initially by a subgroup of like-minded countries operating separately from, but alongside, broader multilateral efforts, to make progress and gain traction. These have both been opened to broader country participation once progress has been made.

Avenues for linking these forums with larger ones are also in place. For example, the rotating chair of ASEAN has a permanent invitation to the G20, while under Australia's G20 presidency this year symposiums will be held to discuss areas of complementarity between the agendas of both G20 and APEC—being held, in fact, next week in Shanghai—and G20 and ASEAN.

While this is only a brief insight into the web of forums and institutions within the region, it provides a taste of how the growing trend towards sub-global forums doesn't have to present an obstacle for international cooperation.

Conclusion

The global backdrop has changed significantly. This has had major repercussions for the environment and the mechanisms for international economic cooperation. Partly in response to the global institutions' failure to adapt to the change, a growing web of sub-global overlapping forums, institutions and arrangements are emerging that, on the face of it, present a risk to international cooperation—and at the very time when it's needed most.

However, I believe this is not an insurmountable challenge. In fact, it can *strengthen* the existing global architecture.

If we remain creative and flexible in how we engage with this web, and if we approach it as providing a complement rather than a threat to the existing global architecture, international economic cooperation can be stronger than ever.

If we don't, the costs from reduced international economic cooperation will be large, permanent and felt by all countries.

Thank you.