LOWY INSTITUTE
FOR INTERNATIONAL POLICY

PERSPECTIVES

The Pacific's Potential: Responding to the Asian Century

Michael Wesley

November 2011

The Lowy Institute for International Policy is an independent international policy think tank. Its mandate ranges across all the dimensions of international policy debate in Australia – economic, political and strategic – and it is not limited to a particular geographic region. Its two core tasks are to:

- produce distinctive research and fresh policy options for Australia's international policy and to contribute to the wider international debate.

- promote discussion of Australia's role in the world by providing an accessible and high-quality forum for discussion of Australian international relations through debates, seminars, lectures, dialogues and conferences.

Lowy Institute Perspectives are occasional papers and speeches on international events and policy.

The Pacific's potential: responding to the Asian Century

Michael Wesley

Keynote address delivered on 5 September 2011 at the conference

The Pacific Islands and the World: Realising the Pacific's Potential

in Auckland, New Zealand

We live in the most dynamic economic region of the world.

If you have any doubt about this, consider the fact that one third of the world's Gross Domestic Product comes from our region, Asia-Pacific.

Compare this with Europe's contribution of 28% and North America's 24%.[1]

But aggregation can be dangerously misleading.

Asia-Pacific includes some of the world's richest and poorest countries.

And it is Asia in particular that is responsible for the spectacular growth. That growth is having a profound effect on the rest of the world.

The global flow of goods, financial resources and people across national borders are all influenced by Asia's economic ascent.

Standing out in this story of a region emerging are the extraordinary growth rates which have made China the world's second-largest economy and India, the ninth largest.

The Asian Development Bank estimates that if the current growth was maintained, Asia Pacific would account for one half of total global GDP by 2050.[2]

No wonder this century has already been dubbed the "Asian Century."

I want to look at how the other part of the region, the Pacific, is responding to the Asian Century.

How is it adjusting to having the world's economic powerhouse in the backyard?

In particular, how are the smaller Pacific Island country economies faring in this new and changing economic environment?

The Pacific is home to neither the world's richest nor the world's poorest.

It does, however, contain a collection of culturally diverse and geographically dispersed countries which are at varying stages of economic development.

Let's be clear on what we mean by Pacific. We're talking about our immediate neighbourhood.

It's sometimes called Oceania by international organisations looking for an easy way to classify us.

But however it's described, it's the region that stretches from the Marshall Islands in the north, New Zealand in the south, Australia to the west and the Line Islands of Kiribati in the east.

To the rest of the world, our Pacific is a corner of the globe that mostly lives up to its name: stable.

However, the challenges and opportunities of our neighbourhood are often not on their radar – we're exotic, a long way away and frankly not that well understood.

In total, around 36 million people live in this part of the world ranging from 22 million in Australia through to just over 1600 in Niue.

And while English is spoken widely across the region, there are more than a thousand living indigenous languages.

Our region's diversity is also reflected in its economies.

Of the 16 members of the Pacific Islands Forum, 14 are developing countries and much of their development assistance comes from the other two members.

In keeping with the wide divergence in the profile and substance of the region's economies, average annual per capita incomes range from just over US$1000 in the case of Solomon Islands through to US$43,000 in the case of Australia.

Along with wide disparities in individual incomes, there are yawning differences between countries' annual growth figures.

Some countries, like New Zealand, are still struggling to grow in the wake of the global financial crisis.

Others – notably, Australia, Papua New Guinea and Solomon Islands – are experiencing strong growth as a result of the resources boom and high commodity prices.

In the case of PNG and Solomon Islands, this growth has not yet been translated into improvements in the quality of life for a large number of their citizens.

This is reflected in the fact that both are lagging seriously behind in their efforts to meet all or at least some of the Millennium Development Goals by 2015.[3]

In the case of PNG, it is unlikely to meet any.

Standing in stark contrast to PNG's continuing high economic growth rates is Tonga's almost flatline performance.

But this simple comparison hides a complex reality for both countries and indeed their sub-regions.

In part, this is explained by the difficulties associated with achieving greater returns in economies that are more advanced and have highly educated work forces.

In other words, PNG's spectacular growth rate is not only to do with the returns on the current resources boom.

It is also to do with the fact that it is starting from a lower base; that it has much further to travel in realising its human potential.

Again, this is reflected in the progress being made by the Polynesia sub-region in meeting the MDGs.

Current indications are that Polynesia is on track to meet most, if not all, of the goals by 2015.

Supporting the island countries' development aspirations and efforts to meet the MDGs are the region's two developed economies, Australia and New Zealand. Together, they provide a significant proportion of the aid. Australia is particularly dominant in this area.

Each year for the past decade, Australia has provided about 53% of the OECD-measured official development assistance in the region, with five other donors collectively delivering much of the remaining 47%.[4]

I raise this issue of development assistance because it represents a significant element of Pacific Island country economies, more so than anywhere else in the world.

Latest figures show that in 2009, Pacific countries received US$184 per person in aid. The next highest region was Africa where ODA receipts for the same period were US$47 per person.[5]

And there is no shortage of donors to Pacific Island countries.

Although Australia is the dominant donor, New Zealand, the United States, France and Japan continue to have a reasonable aid presence spread across the region. However, newer aid donors are playing an increasingly bigger role across the world and our region, most notably China.

I will talk more about China later but it is important to note that there is a wide variety of non-traditional donors that currently have small to medium aid programs in the region.

The number of Asian donors is growing – South Korea, Indonesia and particularly India are using their expanding development assistance programs as an avenue for becoming more active in the international community – and it is likely that Pacific Island states will be a region on their radar for potential growth.

However, aid is only one part of the economic story of the Pacific.

There is no doubt that it plays an important role in assisting a number of Pacific Island states meet their governance responsibilities.

But its contribution and significance varies enormously across the countries. For example, in 2009 it accounted for around 43.7% of Tuvalu's gross national income and 43.5% of the Solomon Islands'.[6]

In fact, it has long been recognised that some of the micro-states will probably rely on some form of external assistance well beyond the foreseeable future.

Yet aid represents a relatively small proportion of the overall GNI in a number of countries.

Aid accounts for 12% of Tonga's GNI, approximately 5% in PNG and down to only 2.5% in Fiji.[7]

This serves to remind us that taking a regional view of the Pacific can blind us to the significant differences among the island states and their different prospects for economic growth and potential.

That potential varies country to country; sub-region to sub-region.

For example, PNG's economy grew at a comparatively phenomenal 8% in 2010 and is set to accelerate even faster than expected due largely to commodity price windfalls and increased mining activity.

In other words, PNG is realising much of its natural resource potential already.

The challenge for PNG is harnessing the income it receives now to fund its future and to structure its economy in a way that supports long-term improvements in human development and productivity.

Other Pacific Island countries do not have the same rich and abundant resources to fall back on.

For a number of countries, remittances represent a significant source of income with Fiji, Kiribati, Samoa and Tonga accounting for 90 per cent of Pacific remittances.

The significance to the economies is highlighted by the fact that remittances to Tonga and Samoa respectively represent 28 and 22 per cent of their gross domestic products.[8]

The downside of labour mobility associated with remittances is the outflow of skilled workers from these countries at the cost of their own labour needs.

Much has been said in recent years about the labour mobility programs which Australia and New Zealand have for Pacific Island workers.

But these focus on unskilled and semi-skilled workers.

Statistics show that a number of Pacific countries have internationally high rates of the skilled emigration outflows. For example, 76.4 per cent of Samoa's tertiary educated population are emigrants; for Tonga, the rate is similar at 75.2%; Fiji 62.2%; Marshall Islands, 39.4%; and Federated States of Micronesia, 37.8%.[9]

Looking at the positive aspect of this trend, it demonstrates that skilled Pacific Islanders have a robust market for their employment.

Tourism too continues to support economic growth in some Pacific countries, particularly Fiji, Vanuatu, Samoa and the Cook Islands.

But tourism has a direct link to trends in the international economy.

In addition to the shape of home economies, rising fuel prices and transport costs are contributing to a slowing down in tourist arrivals.

Australian tourist numbers are declining to most destinations except Fiji and recent New Zealand figures are starting to show a similar trend.

There is a need for greater focus by Pacific countries – Australia and New Zealand included – to put more resources towards attracting and capturing Asian inbound tourism.

An important and positive development in recent years has been the liberalisation of the telecommunications sector and the explosive expansion in mobile telephony.

Tonga and Samoa led the way in encouraging liberalisation and competition in telecommunications and we now see a substantial growth across the region in mobile telephony and laptop use.

This has had a major impact in helping countries reduce the impact of isolation and provide services ranging from internet-based money transfers through to real-time market prices for farmers.

While our region has not been as severely affected by the GFC as other regions, economic growth across the Pacific Island nations has historically been patchy.

There is a list of factors which have long been cited as constraints to economic development in a number of these countries – small populations and land mass, inadequate governance, lack of private sector investment, communal land ownership systems, limited resources, aid dependency and climatic vulnerability.

There are also two other constraining factors which usually appear on this list – one is distance from market or isolation, and the other is vulnerability to global trends.

I want to focus on these two because more than ever before, they are very significant but for two very different reasons.

Isolation is no longer the enormous barrier it once was across our region.

Once upon a time, the Pacific region was distant to the world's economic centres.

We were required to engage with large and powerful economies located far from our villages, farms and factories.

For some of our countries, the distance was too great for the amount and type of commodities we were buying and selling.

But not anymore.

The economic centre of the world is now approaching our region.

Most of our preferred trading partners are already in our Asia Pacific neighbourhood.

The shift in the axis of economic power to Asia is doing much to demolish the tyranny of distance.

Helping to finish it off is the massive growth in mobile telephony across the Pacific.

This brings me to the second critical factor: this new closeness reinforces even further the Pacific's vulnerability to global and regional economic shocks and trends.

The global financial crisis had the effect of accelerating an existing trend in the divergence of the economic performance and capacities of developed and emerging economies.[10]

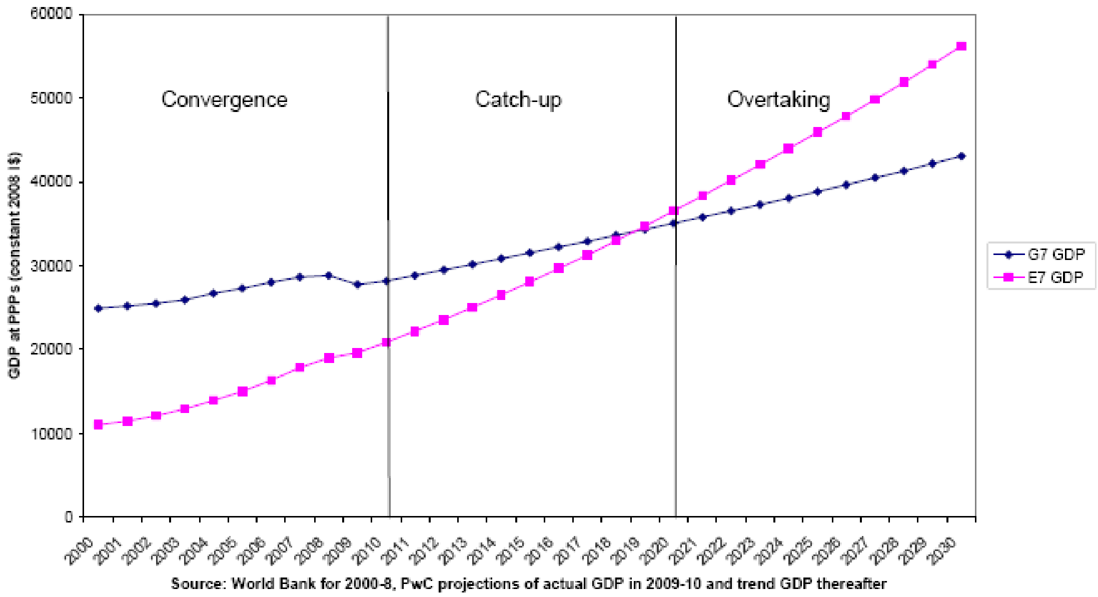
For the best part of a decade before the onset of the global financial crisis in 2008, the economies of Europe, North America and Japan were grappling with the onset of demographic aging, sluggish economic growth, rising unemployment and mounting government debt in the face of generous health and social welfare commitments.

At the same time, emerging economies, particularly in Asia, were growing at rapid rates, with strong employment growth, current account surpluses, and large foreign exchange reserves, and high savings rates.

There was a strong trend towards a 'great overtaking' of developed economies by emerging economies in terms of both absolute size and dynamism.

Figure: Convergence, catch-up and overtaking[11]

GDP at PPP



The GFC accelerated this trend.

The developed world now has high levels of personal debt with even higher public debt as governments have bailed out banks and tried to reflate economies.

The aftermath of the GFC has seen a succession of economic aftershocks around the developed world that continue today and most economists, including our own Mark Thirwell at the Lowy Institute, are predicting the malaise in the developed world will continue for the best part of a decade.[12]

Our region has not been immune to these reverberations.

The reduction in remittance flows and tourist numbers for some of the Pacific countries is just one example.

In short, no matter how small you are and how isolated you think you might be, your fortunes are hostage to what is happening in other parts of the world, and the extent to which external players are engaged with the region.

As the region increasingly embraces Asia, our fortunes will be linked inextricably to the fortunes of our main trading partners.

In other words, this Asian century offers us some new and profitable choices but we no longer have the luxury of persisting with inward-looking economies.

This new circumstance is highlighted by the rise of China's influence in the Pacific which is manifesting itself in a number of ways.

Particularly visible is the considerable increase in its donor activities. But 'estimating China's aid budget is an inexact science' as the Lowy Institute reported in its recent ground-breaking work on China's donor activities in the Pacific.[13]

But through some painstaking research, the report's authors were able to conclude that in 2009, China pledged around US$210 million in grants and soft loans to the region which is similar to the amount which seems to have been pledged in 2008.

But it is not just as a donor that China is known in the region.

The region's trade with China has grown exponentially over the last decade.

The region as a whole ran a record trade surplus with China in 2010, although this is thanks to commodity exports from Papua New Guinea and Solomon Islands – both of which ran large surpluses with China.

Other Pacific Island countries recorded large trade deficits with China.

Chinese exports to the Pacific are growing more popular – because they are cheaper.

Australian and New Zealand companies with niche markets in the Pacific are finding their products undercut by Chinese products.

Chinese companies are investing heavily in Papua New Guinea and elsewhere, concentrating in resources and fisheries projects.

This has not gone unnoticed by the United States.

Secretary of State, Hillary Clinton, warned the Senate Foreign Relations Committee in early March that the US was in a competition with China in the Pacific and quoted China's interests in energy finds in Papua New Guinea in competition with the US corporation Exxon Mobil as one example.

China's increasing influence is also evident even in the way its international broadcasting efforts are starting to gain traction.

In a report completed by the Lowy Institute last year, we noted that there was survey and anecdotal evidence pointing to the increased popularity of China's international broadcaster, CCTV, in some Pacific countries over other broadcasters, including Australia's own Australia Network.

The reason lies in the limited choice available to the viewers but it serves to highlight the various ways in which China is extending its influence across the region.

China has enjoyed significant growth as an economic partner to the Pacific, but a disaggregated look at the trading profile across the region shows a patchwork reality in its economic relationship with different states.

Nevertheless, the reality here is one that reinforces the strong preference for trading partners within Asia-Pacific.

Not surprisingly, Australia, China and Japan dominate in the top two positions of preferred partners but other Asian countries such as Singapore, Thailand, Indonesia, South Korea, Philippines and India also increasingly feature.

While the value of trade fluctuates wildly from country to country with PNG's export figure of close to US$10 billion dwarfing Tuvalu's US$3.5 million, the extent of partners reinforces the way in which the Pacific is linked to external markets.

And it's that linkage and reliance on external markets which brings with it a high degree of vulnerability to the Pacific.

Pacific countries have had to weather the impact of two global pricing crises – food and oil.

While the increase in commodity prices for logs and coconut oil has brought increased revenue to some Pacific countries, this has been offset to a degree by the continuing escalation in crude oil prices.

The price of key food staples has also continued to increase beyond the earlier 2008 global peak.

While the larger countries have more resources to draw on to support their economies through these periods of peak prices, the smaller economies are particularly vulnerable as they are heavily dependent on imported food.

The combined effects of high food and oil prices compounds the impact as transportation costs push food prices even higher.

It's not just the region's small economies that have a distortive reliance on certain markets which can exacerbate their vulnerability to the fortunes of those same partners.

Australia and New Zealand are each experiencing their own versions of economies running at two-speeds.

In the case of New Zealand, the dairy industry is enjoying record growth led by the exceptionally high global prices for milk powder.

While other industries and smaller enterprises in particular are struggling as New Zealand's annual growth rate has only just registered positive figures after six quarters of negative growth in three years.

For Australia, it's the mining sector which is enjoying the benefits of the resources boom while other parts of the economy are sluggish, hindered by a strong dollar.

What is common to both countries is that the principal customer for both the milk powder and the minerals is China.

Australia's fortune is inextricably linked to China as 25% of all Australian exports are to China.

For New Zealand, Australia is still by the far the principal export destination holding a 23% share of the New Zealand market while China sits at 11%.

However, China is the biggest importer of New Zealand dairy products with a more than five-fold increase in sales in the two-year period between 2008 and 2010.

So how should the region's governments respond to the opportunity and risks that the Asian century presents?

It's clear that the response is not simply a job for the private sector.

Our political leaders have an indisputable role in guiding that response to ensure the greatest possible benefits accrue to our countries at the lowest possible environmental, social and future cost.

It is an area which can be fraught with risk for a political leader.

An example of that close to my home is the fall of Kevin Rudd as Prime Minister last year in the wake of the attempt by his government to impose a super-tax on mining companies attaining extraordinary profit from the mining resources.

It wasn't the only reason for his downfall, but it certainly contributed.

That said, it is very encouraging to see PNG's efforts to establish sovereign wealth funds to ensure that the revenues from the mining and gas extraction projects are saved for future generations.

It is also important for us to consider how, as a region, we respond to the opportunities and risks.

New Zealand's foreign policy outlook has continued to focus on its relationships with countries in our region and the wider Asia-Pacific.

Foreign Affairs Minister Murray McCully visits the region frequently and a healthy debate continues amongst civil society in New Zealand as to the aid program's focus on and contribution to the Pacific.

Australia's relationship with Pacific Island states should be stronger than ever.

Australia successfully hosted the Pacific Islands Forum in Cairns in 2009.

The Parliamentary Secretary for Pacific Island Affairs, Richard Marles, has a proactive and energetic engagement with the region.

Australia continues to be the largest aid and trading partner of the Island states. However, Australia has been complacent and distracted in its engagement with the Pacific over the past year.

The government has spread already thin diplomatic resources[14] further afield and has prioritised new and non-traditional relationships in efforts to secure a seat on the UN Security Council.

Unfortunately, this has come at the expense of building on and enhancing relations with our nearest neighbours in the Pacific.

The region is moving on from that first generation of post-independence leaders.

We are on the cusp of a major generational change among the political leadership.

As the younger leaders move up to take charge of their countries, this is an important opportunity for New Zealand and Australia to work closely with this new generation; to give them the support but also the space to achieve better things for their countries.

One of the biggest challenges facing this new crop of leaders stems from the youth bulge that is characteristic of many Pacific Island countries.

They will be under pressure to improve their countries' economic performance to create the jobs for the increasing numbers of young people leaving school.

Six new leaders will be attending the 2011 Pacific Islands Forum in Auckland.

It is important that new energy be channelled by the regional community into looking more creatively and constructively at how cooperation and coordination will better serve our regional and national interests.

Conclusion

So in concluding, I put this question to you – do we embrace and take advantage of the Asian century that we currently live in?

Do we ride off the back of Asia's economic fortunes, take advantage of their larger populations and ravenous consumption of worldwide resources?

Should we seek further integration with Asia and take advantage of the fact that the economic centre of the world is conveniently coming to us?

Or do we devote our collective efforts towards asserting the 'Pacific' in 'Asia-Pacific' and create our own pathways towards greater economic development and prosperity for our populations?

Certainly, this would be more difficult and would require a stronger and more assertive regional framework.

There would be no guarantee that economic gains would be as great.

It's clear that some of us have already answered that question – our countries' trade figures speak for themselves.

But have we done enough to ensure that the revenue we're earning is being used well enough to meet current development needs and hopes?

And have we done enough to ensure that our actions today won't bankrupt our country's environmental, social and economic future? I look forward to hearing your answer.

[1] Asian Development Bank, *Key indicators for Asia and the Pacific 2011*. Singapore, ADB, 2011, p 156.

[2] Asian Development Bank, *Asia 2050: realizing the Asian Century*. Singapore, ADB, 2011, p 1.

[3] Pacific Islands Forum Secretariat, *2011 Pacific regional MDGs tracking report*. 2011.

[4] OECD Development Assistance Committee, *Development aid at a glance: Statistics by region - Oceania.* 2011.

[5] Ibid.

[6] The World Bank. *Net ODA received (% of GNI).* http://data.worldbank.org/indicator/DT.ODA.ODAT.GN.ZS.

[7] Ibid.

[8] Migration and Remittances Unit World Bank, *Outlook for remittance flows 2011-2012.* 8 November, 2010.

[9] World Bank, *Migration and remittances factbook 2011*, 2nd ed. Washington, The World Bank, 2011, p 9.

[10] OECD, *Perspectives on global development 2010: Shifting wealth.* Paris, OECD, 2010.

[11] John Hawksworth, *Convergence, catch-up and overtaking: how the balance of world economic power is shifting.* London, PriceWaterhouseCoopers, 2010.

[12] Mark Thirlwell, *Our post-GFC world economy.* Lowy Institute Perspective. Sydney, The Lowy Institute for International Policy, 2010.

[13] Fergus Hanson and Mary Fifita, *China in the Pacific: the new banker in town.* Lowy Institute Policy Brief. Sydney, The Lowy Institute for International Policy, 2011.

[14] Andrew Shearer and Alex Oliver, *Diplomatic disrepair: rebuilding Australia's international policy infrastructure.* Sydney, The Lowy Institute for International Policy, 2011.