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The New World

In early November VECCI will be hosting the very important Victoria Summit looking at the issues and challenges facing this State. What I want to do this afternoon is to provide some international context and perspective to that debate.

I once worked as an intelligence analyst in the Office of National Assessments. My great boss there, Michael Cook, the Director General, used to exhort us when looking at the world to ignore the turbulence of the surface waves around us and focus instead on the directions of the deep ocean currents, the real shapers of our environment.

Of those deep ocean currents in the world at present, the most important, I think, is globalisation. By that, I mean that it seems to me to be the central driver of international relations in the early twenty first century. It is not the only thing that matters, of course. But it is the thing that provides the most useful way of understanding the world. The emergence of nationalism performed the same sort of function in the nineteenth and twentieth centuries.

My three messages today are that globalisation is here to stay, that it is developing an increasingly Asian face, and that under the right circumstances Australia and Victoria are well-placed to benefit

Let me begin by trying to clear away some of the confusion about what globalisation is.

You don't have to look far to see a feisty argument going on about it – from those on the left who equate it with neo-liberal free market economic thinking and denounce its impact – the demonstrators against the WTO in Melbourne a few years ago or against the Forbes Global

Summit in Sydney recently - to those on the right who think it means that national sovereignty is being lost to shadowy organs of the United Nations and a conspiratorial New World Order.

The problem is that the word “globalisation” is used in very different ways by different people to mean different things. But really it is nothing more than a description of what is happening in the world. It is a process not an ideology.

In my view Tony Blair got it right when he told the British Labour Party conference last week. “I hear people say we have to stop and debate globalisation” he said. “You might as well debate whether autumn should follow summer.”

Globalisation is the result of a technological revolution over the course of the second half of the twentieth century, a revolution in transportation, mobile telephony and digital communications such as personal computers and the internet. But you can boil all that down to one simple fact: technology slashed the cost of transferring things – and particularly information - around the world. The figures are well known. The cost of a three minute transatlantic telephone call fell from about \$US250 in 1930 to a few cents today. And the internet brings communications costs close to zero.

Governments slowly came to understand that dismantling the barriers to trade and investment from the outside would generate a substantial economic benefit. The most lasting result of this was that in the last quarter of the twentieth century, one billion people in China, another billion in India and 400 million in the former communist states of Eastern Europe began to embrace market capitalism.

The result of these developments was the huge increase in global economic interdependence we saw over the 1980s and 1990s - the development of global supply chains in manufacturing and the explosion of trade and foreign direct investment that were the inevitable result of this.

So by the end of the twentieth century the international economy was burrowing more deeply than ever before into national economies. The vertical integration of companies meant that the component parts for a single product and the associated services could be sourced to many different countries. In a speech here in Melbourne last year launching a Lowy Institute report about the Indian economy, the Victorian Treasurer, John Brumby, gave a good example of an experience he had recently had with the global supply chain. He said he was at home ‘accessing the internet through a computer assembled in Taiwan, using Irish-built processors and running software developed in the US, to buy a product designed in Italy and manufactured in China. My

credit card will be processed in India, the product shipped from a warehouse in Singapore on a Norwegian freighter, tracked by an Australian TDL company and delivered to my door by a van assembled by a Korean subsidiary of a German-American automotive company.'

One of the measures of what is happening is that trade in goods and services now accounts for half of all global output. Fifty per cent compared with just 38 per cent as recently as 1990. And much of this is trade within companies as part of those global supply lines.

Another measure of globalisation's impact is the huge increase in Foreign Direct Investment, which now represents about one fifth of global output. As a share of the world economy, FDI rose from 9 per cent in 1990 to nearly 23 per cent in 2003.

You can add to these economic measures the transforming cultural implications of rapid and open flows of news and information through the internet and satellite television – the CNN effect - as well as the freer movement of people that cheaper transport has facilitated. Around 200 million people now work outside their own country. One million Australians - five per cent of our population - are overseas at any one time.

The result is that there is hardly an aspect of our society or economy in Australia, whether education or health or manufacturing industry or agriculture or entertainment, that is not directly affected by what is happening overseas.

But how confident can we be that these changes are permanent? Some globosceptics suggest that we saw something similar in the international economy before the first world war – and look what happened to that. What if this good news turns out to be reversible?

One point to make in comparison with the past is that this time around the structure of globalisation is different. The vertical integration of supply lines gives companies and governments a much greater interest in the stability of the system, and the new globalisation embraces vastly greater areas of the world.

But certainly there are threats. After all, in the past week we've been reminded by the bombings in Bali that the capacity of extremist Islamist terrorists to bring chaos and carnage remains. And we always have to be alert to the dreadful prospect of one of those groups getting hold of a nuclear or biological weapon of some description.

But in the end I'm an optimist about the struggle against terrorism. I don't doubt the difficulties in responding to it, or the time it will take, but in my mind at least there is no doubt about the result

of the struggle. Islamist terrorists do not challenge our existence. They can disrupt our lives but they cannot prevail here. And in the more important struggle that has to take place within the Islamic world, I think moderation will eventually prevail. A democratic Indonesia provides a more likely model for the future of the Islamic world than does the establishment of a medieval caliphate.

So I don't think terrorism will deflect the deep ocean current of globalisation.

Nature might be a more significant threat. We've been reminded by the Boxing Day Tsunami and Hurricane Katrina of how potent natural disasters can be. And we have no good grasp of the implications that a shift of a few more degrees of global warming might have on our lives.

Although the terrorist attacks of 9/11 did not greatly affect global growth, a global pandemic like avian influenza might have a much more serious economic impact. If the H5N1 virus mutates to enable easy human to human transmission a pandemic on the scale of the Spanish influenza pandemic of 1918 seems entirely possible. If it happens, as Health Minister Tony Abbot said at the weekend, "ordinary life as we know it will cease, probably for about six months".

But while globalisation would certainly be stopped in its tracks by such an event, it would not be reversed and the world would eventually continue on its present trajectory.

Also on the positive side of the agenda we need to remember one enormous, largely overlooked, blessing at present. The chance of major war between the great powers – the very thing which devastated the twentieth century, and most centuries before it – has seldom been less than it is now. The Cold War which dominated our lives until the early 1990s with the awful possibility of devastatingly destructive nuclear exchanges is over. War between the major European powers is unthinkable. And none of the major powers has the will, and only the United States has the capacity, to use military force on a strategic scale against the others. That environment is unlikely to change for at least several decades to come.

So I think globalisation will continue, and my second message today is that it is helping to shift the economic and geo-strategic balance of power in the world towards Asia.

You can measure the size of economies in a couple of ways, but if you use purchasing power parity which is best for comparing wealth between nations, the United States is the largest economy in the world but three Asian countries China, Japan and India - fill the next spots.

China's economic reforms began after the disasters of the cultural revolution when Deng Xiaoping began opening up first rural and later urban areas to market oriented reforms. Deng famously declared "It doesn't matter whether a cat is black or white, as long as it catches mice." They have been catching lots of mice in the years since. When the Chinese leadership decided in 2001 to let capitalists join the Communist Party of China, it was a fair sign that things were changing. The result has been historically unprecedented growth. Since 1978 and the launch of reform the Chinese economy has grown at an average of more than 9 per cent each year.

In the past five years, China has more than doubled its share of world merchandise trade. It is now the single most important contributor to the overall growth in world trade. It was the largest recipient of foreign direct investment in 2003, and more than half its exports are now produced by foreign-owned firms or joint ventures.

The rise of India, the world's other one billion people plus economy, has been less dramatic than China's, partly because of the constraints of democracy. But it is still impressive. Reform began in the early 1990s and economic growth averaged 6 per cent per year in the decade from 1996. India's growth model is based on services rather than manufactures, taking advantage of some of its people's language and technical skills.

I want to emphasise that there is nothing especially remarkable about this trend. The really remarkable thing is that we had a couple of centuries in which – largely because of the industrial revolution in Europe and disastrous failures of governance in China and India – the wealth of two of the world's most populous countries slumped so precipitately. So what globalisation is really doing is just returning China and India to their former positions of importance in the global economy, as you would expect from two countries with a combined population not far off 2.5 billion. In 1820, China and India together were worth almost 50 per cent of world trade, but by 1950 that had dropped to only 7 per cent. In 2001 the figure had risen back up to almost 20 per cent.

The other big Asian player, too often overlooked in this debate, is Japan. It is a style thing as much as anything. There in the corner of the great Asian party – while people all around are swigging champagne and blowing party whistles - stand the Japanese in their dark suits, white shirts and sober ties. Not looking as if they're having much fun. But Japan remains a huge economy – on exchange rate measurements the second largest in the world - the world's third largest military force and Australia's largest export market. After a decade and a half of economic stagnation as a result of structural problems in its economy, with a declining population, faced with the rising power of China, Japan is undergoing a basic reassessment of its future. Its

economy is undergoing huge structural change, its political system has been shaken up by Prime Minister Koizumi's success in remaking the dominant Liberal Democratic Party, and it is reassessing its post-war pacifist constitution and sending peace keepers overseas, including to Iraq where they are being assisted by Australian forces. As a result of all this, though with typical cultural introversion, Japan is engaged in a fundamental debate about its future that will have large consequences for Asia.

What about the future? The federal Treasurer, Peter Costello, in an address to the Lowy Institute last week – and I assure you we have people other than Treasurers speaking to us - described the likely shape of the world in 2050. As he acknowledged, it's a dangerous exercise to project the present into the future. But whatever caveats you offer, it is hard to avoid the conclusion that by the middle of this century China's and India's economic importance in the world will have increased substantially. Measured by purchasing power, China had 13 per cent of the world's GDP in 2004. By 2050 it is expected to reach 20 per cent. India will grow from 6 per cent to 12 per cent, the US will slip from 21 per cent to 14 per cent and Europe from 21 per cent to 10 per cent. Australia will decline more modestly from 1.1 per cent to 0.7 per cent.

So far we have been talking just about economic growth. But economic growth forms the foundation for two sorts of national power – hard power, that is military weight and the willingness to use it, and soft power, which is the capacity to influence people culturally and through ideas. More of both these elements of power are likely to come from Asia in the years ahead.

On the first, China and India will inevitably seek to develop military capabilities commensurate with their size and influence. Like Japan, they will have an eye on the security of the supply lines of resources and energy so critical to their continuing growth. China has already increased defence spending roughly threefold over the past ten years and has introduced technologically sophisticated, high quality weapons systems, particularly directed against Taiwan.

On the second sort of power, soft power, Asia will also become more important. We have been used to thinking about globalisation as a form of Americanization or at least westernization. Cultural influences, including Hollywood and popular music, have been an important element in America's soft power - its capacity to influence others. But globalisation will develop a more Asian face in the decades ahead. Korean brands have already joined the Japanese as Asian global brands but China and India will certainly be next. Even in global popular culture, Bollywood, Chinese martial arts films, Japanese *Manga* comics and *anime* and games like Pokemon are having a growing impact.

I'm not suggesting that this shift in the global balance of power towards Asia will be smooth. Both China and India face serious challenges of sustaining growth and defeating poverty. And Japan has extraordinary demographic problems as its population shrinks in size. The management of China's and Indian military growth leaves huge potential for miscalculation, and it is by no means clear how the United States will react. Will Washington accept a change in the East Asian balance of power or will it try to contain China as it contained Russia? These are big questions with answers that could be dangerous if the process is mishandled. One way or another, Asia will certainly be the forum for the most important geo-strategic competition of the coming decades.

These developments just reinforce my belief that if you continue to focus on the deep ocean currents rather than the surface waves, the world in 2050 will certainly look, in a number of different ways, much more Asian.

So let me now try to bring my conclusion that globalisation will continue and that it will have a more Asian face back down to ground and talk about the implications this has for us in Australia and for Victoria. The immediate answer is that it is good news.

Australia has done well out of globalisation. With the great raft of economic reforms in the 1980s and '90s we positioned ourselves to benefit from the new opportunities globalisation was offering. The result was that as our economy opened up we became richer. Average effective rates of manufacturing assistance in Australia fell from 22 per cent in 84/85 to 5 per cent in 2000/01. And by 2001/2 according to the Department of Foreign Affairs and Trade, Australians were around 55 per cent better off than we had been in 1979/80, with real GDP per capita of \$36,000 compared with \$23,000.

Australians are good at both government and governance. That's something we don't often acknowledge, but it is a rarer asset than we sometimes imagine. We have an old and effective democracy and a society which, for all our proper self-criticism, remains open to social mobility and to newcomers arriving here. Open societies which can attract talent from all over the world are going to be well-placed to succeed in the years ahead. We have also shown in a period of twenty years of transforming economic change the capacity to adjust to external pressures and to manage internal change effectively.

And Asia's re-emergence as a global power centre is excellent news for us. Much of what we sell has gone up in price, much of what we buy has become cheaper. Our economies are largely complementary. We have resources and energy supplies that Asia needs; we have services ranging from education and tourism to accountancy and architectural design that Asia wants.

The growing number of Asian Australians represent an important resource for us. Our international businesses in Asia, and the skills and commitment of Australians working there, are a very important element in Australia's national "soft power".

But we are fooling ourselves if we think these opportunities will fall to us by right of location. Proximity is still useful in a globalising world but it is by no means sufficient.

In many ways, Australia has done the easy things, the obvious reforms. But the pressures on us will not diminish. For example, one important result of globalisation has been to make services jobs tradable. Not just things like back office work and call centres but high end services such as design, education and medical services. It is possible that India will do to services industries what China has done to manufacturing industry. Like all developed and older developing economies we will face substantial adjustment strains as China and India attract both blue collar and white collar jobs (though less than might have been the case before our reforms).

The lesson for us is that all Australian businesses are going to have to continue operating at the highest levels of innovation and efficiency. They are going to have to understand not just what is happening in that the local market but in the global one. It's an exhausting thought. But if we press ahead with economic and social reform, if we keep ourselves open to the world, if we maintain our infrastructure, if our businesses keep innovating, if we deepen our scientific base, if we improve our education systems, the trend in global economic power back towards Asia will bring great benefits.

We've just got to remember all the time that those are big ifs. It is particularly important that we nurture our Asian expertise and language skills, which are now slumping badly. Fewer than three per cent of Australian university students are now studying an Asian language. Leave aside whatever the cultural benefits might be, the commercial reality is that if you are engaging in economic transactions with partners who know more about you, and understand you better than you understand them, they hold an important practical advantage.

When John Batman sailed up the Yarra and declared that this was the place for a village, he was reflecting an idea of a city that had existed for millennia before him – that is, cities should be located at a confluence of resources – water, fertile land or, later, minerals – and access, somewhere people and things could move in and out of easily, usually by rivers or seas.

The thing about globalisation is that it reminds us that the places where villages now grow - new places like Silicon Valley or old places like Shanghai and Bangalore – succeed because they bring together ideas and the energy and capacity to implement them.

