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Hitch our dream to an Asian star
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China and India hold the key to our long-term standard of living as long as they can deal with their external risk factors, writes **Mark Thirlwell**

THE distribution of economic weight in the world economy is moving back towards Asia. This process of global re-orientation will undoubtedly involve some transition strains for the international economy, and as a result many countries will tend to feel at least some degree of apprehension as the economic balance of power tilts eastward.

But the good news is that Australia's long-term economic prospects should be given an important boost by this trend, through greater demand for Australian exports and by an increase in Australia's attractiveness as a destination for overseas investment.

Back in the early 19th century, China and India accounted for almost half of world output. Yet by the outbreak of World War I, the share of global GDP for the two countries had fallen to less than one-fifth, and by the early 1970s they accounted for less than a tenth of global output.

The acceleration of Chinese economic growth that began with economic reform in the late 1970s, together with the more recent pick-up in Indian economic activity following the 1991 reform effort, means the trend of relative economic decline has moved rapidly into reverse.

China and India have been two of the world's fastest growing economies in recent years, and their share of global output has risen accordingly. Using the World Bank's purchasing power parity measure of GDP, the two countries accounted for about 18 per cent of the world economy last year and were the world's second and fourth largest economies respectively.

True, their relative importance is lowered when output is measured using market exchange rates (their rankings slip to sixth and eleventh, and their combined share of global output to about 5 per cent).

But here, too, the direction is upwards. Recent work by Goldman Sachs suggests that on current trends China's economy could be larger than the US's by 2041 in US dollar terms, while India's could be larger than all but the US and China in 30 years' time.

Of course, there are dangers in placing too much weight on simple trend-type extrapolations. For example, both countries face significant external risks -- Taiwan in the case of China, Pakistan for India -- which if mismanaged would have severe consequences for economic development. And even if such significant threats were avoided, economic history suggests that the process of integrating with the global economy is fraught with difficulties. China and India would need to be very skilful and very lucky to avoid some kind of economic or financial crisis as they push ahead with economic reform.

This means one critical issue determining the economic fortunes of both economies will be the effectiveness of the policy response to such a crisis when it arrives, and the resilience of each country's social and political fabric to the economic fallout. Despite some significant risks, however, the most likely scenario for the global economy remains one in which the economic weight of the world continues to shift towards Asia.

This should provide a long-term economic boost for Australia, since Australia's mix of geographic location, resource base, strong economic and political institutions and educated workforce make it particularly well-placed to benefit from expanding Asian economies and able to ride out the associated adjustment strains.

For example, Australia is likely to be an important source of the raw materials and energy needed to feed the latest wave of Asian industrialisation.

Past experience with Japan and South Korea has demonstrated Australia's ability to be a reliable supplier and key partner in industrialisation.

This is a history lesson that has already been absorbed by China -- hence the recent energy deals and the expressed interest in a free trade agreement -- and one that is likely to become increasingly apparent to India.

Moreover, as economic development progresses and income per capita increases, Australia is also in a good position to service the demand for food and beverages of increasingly wealthy Asian consumers, as well as to provide an attractive destination for a new supply of tourists.

At the same time, an expanding Asian manufacturing base should provide Australian consumers with a steady supply of competitively priced manufactured products.

The net result should be strong, sustained support for Australia's terms of trade and hence for living standards.

Finally, there could also be important indirect gains from global re-orientation for the Australian economy, in terms of increasing Australia's attractiveness as an investment destination.

Investing in Australia could provide international investors with an attractive way to take relatively low-risk exposure on global re-orientation, since not only will the Australian economy benefit from the trend shift in global activity towards Asia, but the country's robust institutions and good economic management mean that it is also relatively well positioned to ride out the economic turbulence that will occur around that trend.

Indeed, Australia's performance during the 1997-98 financial crises in East Asia demonstrated the economy's resilience in the face of an adverse regional shock, and its ability to adapt flexibly to shifts in the pattern of external demand.

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