

Discussion

1. Mark Thirlwell*

Yiping Huang and Bijun Wang have written an interesting paper looking at how the past decade has transformed the Asian economies and speculating as to what further changes the next 10 years might bring. Starting with the past decade, the authors concentrate on what they see as three of the most fundamental changes:

1. the rise of vertically integrated supply chains across the region and the associated role of regional demand in driving a commodity super-cycle;
2. the emergence of large current account surpluses, the accumulation of huge stocks of foreign exchange reserves and the consequent rise of Asia as a major capital exporter; and
3. important but nevertheless strictly limited progress with formal regional integration efforts.

Turning to what the next 10 years might bring, Huang and Wang focus in particular on the sustainability of the region's – and especially China's – growth performance, and reach the plausible judgment that growth in the years ahead may turn out to be slower but of a higher quality. They also canvass a range of other issues, including the prospects for ongoing structural change, further steps towards the liberalisation of China's exchange rate regime, the mixed prospects for further regional integration and the possibility that the next major international economic crisis will originate in Asia.

Their paper covers a lot of ground and it's hard to disagree with many of the judgments they make. Of course, much else has happened over the same period and it is easy enough to think of a range of other developments which might have squeezed onto their list in the absence of constraints on time and space. To take just another three examples, they could also have discussed:

1. the continued rapid pace of urbanisation across the region, which is currently seeing Asia add some 44 million people to the urban population each year; in China alone the urbanisation rate has risen from 36 per cent in 2000 to 47 per cent in 2010 in what has been a major contributor to resource demand;¹
2. the ongoing demographic transition, with much of east Asia in particular now in the process of leaving the demographic sweet spot behind, with some projections suggesting, for example, that the working-age population in China and South Korea will peak around 2015;² and
3. the significant changes in regional poverty levels and in income distribution, including the emergence of that marketers' dream, the new Asian middle class, alongside concerns regarding growing inequality.³

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1 See Asian Development Bank (2008).

2 See, for example, Bloom and Finlay (2009).

3 See Kharas (2010) and Sharma, Inchauste and Feng (2011).

It also seems entirely appropriate that a conference looking at the Australian economy in the 2000s should open with a paper covering developments in the Asian region.

Over the past decade, Australia's ties with Asia in general, with east Asia in particular, and with China most of all, have deepened significantly. As the global centre of economic activity has moved to the east, and closer to Australia, so the gravitational pull of the Asian region on Australia's economic fortunes has increased.⁴ So, for example, while east Asia already accounted for around 45 per cent of total (goods and services) Australian trade flows by value in 2000, by 2010 that share had increased by about 10 percentage points.⁵ More specifically, while China only accounted for less than 6 per cent of total Australian trade in 2000, by 2010 that figure had jumped to more than 19 per cent. Granted, the investment relationship with the region has lagged well behind the trading one, although even here, by the end of the decade Chinese investment into Australia's resource sector had started to expand appreciably. Meanwhile, developments in the Chinese economy have become increasingly important drivers of market sentiment and hence of asset prices, including the share market and the exchange rate. Perhaps most dramatically of all, over the past decade China's voracious appetite for resources has helped power Australia's terms of trade to record highs and so reshaped the pattern of national comparative advantage.⁶

In order to understand many of the key forces that have helped shape the Australian economy over the past decade, and which are widely expected to do the same over the next decade, it does therefore seem to make an awful lot of sense to start off by thinking about developments in, and prospects for, the Asian region.

That said, however, from the perspective of tracking movements in goods, services and capital, it seems reasonable to ask whether a focus on a strictly geographical 'Asia' makes as much sense as other ways of cutting the data. Where geographical definitions map neatly on to political and economic institutions – say in the case of the European Union, or maybe the euro area – then perhaps adopting this kind of geographical shorthand makes sense. But in a region where this is not so, there is a case for using, say, network analysis to map actually existing economic flows and relationships to provide a different framework.

Alternatively, there is a plausible case – particularly but certainly not entirely from an Australian perspective – that the most important developments over the past decade have been not so much about Asia overall as about China. As is well known, over this period China has become the world's largest exporter, second largest importer, second largest manufacturer and largest single source of global savings. According to a recent International Monetary Fund (IMF) stocktake, for example, in 2000 China was the first or second largest trading partner of just 13 countries, which between them accounted for about 15 per cent of global GDP; now it holds the same position with 78 countries accounting for 55 per cent of global GDP. From a network perspective, China is now the world's most 'central' trader and has a growing, systemic importance.⁷ While China's main interaction with the rest of the world economy is through trade flows, financial linkages

4 See Quah (2011).

5 See Thirlwell (2011).

6 While demand from emerging markets has played a key role in driving the resources boom, it has not been the only factor at work, with other factors in play including easy US monetary policy. See, for example, Cagliarini and McKibbin (2009).

7 See International Monetary Fund (2011).

are also on the rise. And as noted above, China's importance to the Australian economy has risen markedly over the past decade.

The huge increase in China's relative size over the past decade certainly dominates any simple accounting of regional economic trends: between 2000 and 2010 China's share of regional GDP has increased by much more than 10 percentage points, regardless of whether output is measured using purchasing power parity or US dollar exchange rates.⁸ That's been mirrored by an equally sharp decline in the share of Japan, while there have been only comparatively minor changes in the shares of the other economies. Similarly, a look at the value of world merchandise trade in 2010 shows that the value of, for example, Indian trade is just 18 per cent of that of China's and even Japan's trade is a little less than half of China's by value.⁹

In other words, while the paper does a good job in keeping its focus broader than that of one economy, there's also a case to be made that one economy is where much of the key action has been found.

Sticking with a China-centric perspective for a moment, one interesting way of thinking about the past decade is as one which has seen the Chinese development model deliver strong growth and rapid structural change but which has also, perhaps, pushed that model close to its limits: the hefty percentage point increase in the ratio of investment to GDP and the parallel squeeze on the private consumption ratio over the past 10 years are both suggestive of limits now either rapidly approaching or already reached. This is recognised in the paper, which makes the sensible judgment that the future rebalancing of the Chinese economy will see somewhat slower, but also more sustainable and higher-quality, growth. While that may well turn out to be right, growth transitions can be far from smooth and a sharper, more discontinuous, adjustment would seem to be a significant risk. That said, as the figure of (failed) past consensus forecasts of Chinese growth slowdowns reproduced in Connolly and Orsmond (this volume) makes clear, betting against the policy-makers in Beijing has so far been a losing proposition.

Finally, the changing nature of the external environment within which both the Chinese model and the Asian development story have unfolded is another potentially fruitful issue to consider.

For example, the paper rightly emphasises the central role played by the growth of regional production chains over the past decade. It follows that one important question is the extent to which the current configuration of regional production reflects the circumstances of the past decade or so: strong US consumption demand; open rich country markets; particular multinational corporation growth strategies; a specific configuration of energy and transport costs; and so forth. Given that the current decade is already seeing substantial changes to many of these variables, the way in which the current regional growth model adapts to these new circumstances will be critical.¹⁰

Also, there have been significant changes in the global institutional arrangements within which the region operates. The rise of the G-20 has arguably been the most important of these from a

8 Based on calculations comprising China, India, Japan, the ASEAN-5 (Indonesia, Malaysia, Philippines, Thailand and Vietnam) and the four NIEs (Hong Kong SAR, Singapore, South Korea and Taiwan) using the IMF *World Economic Outlook* database.

9 Values calculated from World Trade Organization statistical database.

10 See the discussion in Yusuf and Nabeshima (2010).

regional perspective, but the ongoing failure to conclude the Doha Round of world trade talks and the strictly limited progress with IMF reform (the Europeans have once again managed to maintain their grip on the leadership of the Fund despite all of the changes in the international distribution of economic weight) are also noteworthy. Similarly, the growing strains apparent in the euro area experiment may also have significant demonstration effects on future regional integration initiatives.

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2. General Discussion

The initial discussion centred on the Chinese growth model and, in particular, China's exchange rate regime – seen as a key weakness of the growth model. It was suggested that the undervalued yuan was generating inflationary pressures in China, with sterilisation doing little to offset this. Furthermore, the undervalued currency was seen by one participant as a key determinant of global inflationary pressures. During the latter part of the 2000s, high energy and food price inflation had been accompanied by rising manufacturing prices (unlike the first half of the decade where manufacturing prices were falling), feeding into higher inflation in the United States and Europe. Another participant, however, suggested that greater technological progress and enhanced productivity in China would work to offset increasing cost pressures in the economy.

The discussion then turned to the next phase of China's economic development, transitioning from the current high growth model to a more sustainable development pattern along the lines

of that experienced by other major economies. Key questions raised by participants included how the transition will take place and whether it can play out without causing substantial dislocation for the economy. Participants thought that a substantial realignment of the real exchange was necessary to match the dramatic shift in economic weight towards the region in the past decade. It was also mentioned that distortions in factor markets (capital, labour and land markets) will need to be removed in order to facilitate the transition of the Chinese growth model. One participant thought that there were already signs of this occurring, noting that income inequality had improved somewhat, regional development was becoming more balanced (helping to increase consumption) and real wages have been increasing. Further helping the rebalancing phase, a number of forces working to reduce China's saving rate were highlighted by another participant, including: lower real interest rates making saving less attractive; the improving social welfare system; and demographic shifts (with demographics to become a challenge from the middle of the decade, when the dependency ratio starts rising – Japan's experience was mentioned here).

The possibility of a slowdown or even a financial crisis in China was also a topic of substantial discussion. Rapid urbanisation (an 'urbanisation avalanche') and overheating in the residential construction industry was seen by one participant as a potential risk in China, and the likely trigger for any domestically generated crisis. There was also a discussion on the appropriate ordering of financial reforms – should domestic financial liberalisation precede exchange rate liberalisation? It was mentioned that while the reforms taking place to push domestic financial liberalisation were a good thing (e.g. opening up capital markets would impose discipline on banks), there was a risk that if markets were opened up too much and too soon it could lead to a financial crisis (although it was mentioned that a 'mild' financial crisis could actually lead to reforms and a stronger financial system in the medium term). Related to this, one participant asked how difficult it would be for China to repeat the fiscal stimulus seen during the global financial crisis if there was a sharp downturn. In response, it was suggested that Chinese authorities would probably still respond rather than letting growth slow significantly.

Finally, one participant argued that, based on technological convergence grounds, we should expect to see the growth rate in China slow at some point. Another participant also thought that the strong growth in China, driven by capital deepening, was in line with an exogenous growth model where an economy is a long way from equilibrium.

