Can Asia Help Power the Global Recovery?

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When the global financial crisis hit the U.S. and European economies in 2008, the emerging economies in Asia—with their high rates of growth, huge current account surpluses and export-oriented growth strategies—were an easy target for those in the industrial world who had difficulty coming to terms with the mess they had made of managing financial markets in a era of seemingly unlimited cheap international capital. Rebalancing global growth became the mantra for how to shape the contribution of emerging economies to ending the global recession, temporarily hiding the need to rein in structural deficits and financial imprudence in the developed world. As Europe teeters toward another crisis, threatening to shatter confidence in America's tentative recovery and global markets, emerging economies have come to be seen as the savior of global economic growth rather than a culprit of the current mess.

Europe is currently facing the second-round political effects of the strategies that have been painfully put in place to engineer economic recovery. Europe's politicians were hamstrung by the difficulties in forging the parliamentary majorities needed to pass measures designed to lift confidence and get the recovery on track. Now they are confronted with the difficulty of maintaining these majorities as the blunt surgery used to root out the cancer that caused the crisis has left the body politic fragile and resentful, weakening its resolve to stay on course. The prospect of governments that committed to the European recovery strategies collapsing threatens the entire European recovery. As political turmoil compounds economic turmoil, it seems clear that restoring confidence will be a slow and painful process.

The G-20 leaders' meeting in Los Cabos will not only need to maintain leaders' resolve but also encourage new commitment to further measures to stimulate global growth. At no juncture has the G-20 had a more critical task in bridging the gap between national and global political interests.

While there are worries about slowing global growth, China and other emerging economies have forged through the global financial crisis, maintained strong rates of growth despite their shrinking export markets in industrial countries, and made a significant positive contribution to global growth. The international community and particularly policymakers in the United States have put great expectations on the contribution that China should make to global economic recovery by rebalancing its economy and reducing its current account surplus through promoting consumption growth. But there is growing evidence that this rebalancing is in fact happening.

Until recently, China's current account surplus was seen as a big problem but the current account surplus has fallen from over 10 percent of GDP in 2007 to 2.8 percent of GDP in 2011. The International Monetary Fund's most recent prediction is that the current account balance is likely to remain at normal levels with forecast surpluses of 2.3 percent and 2.6 percent in 2012 and 2013 respectively. In contrast, in September last year, the IMF was still forecasting a 5 percent current account surplus this year and the IMF's 2011 Article IV consultation with China identified the current account surplus as a problem that needed to be fixed.

With decreasing trade and current account surpluses, declining foreign exchange reserves and

even expectations of a currency depreciation late last year, estimates of the undervaluation of the renminbi (RMB) have been drastically revised downwards. Wages have in fact risen rapidly (with all the indications that a wage explosion is on the way in the industrial coastal provinces), implying an appreciation of the real exchange rate in China; and while regulated interest rates did not change much, the proportion of financial intermediation subject to market-based interest rates has risen sharply. There is also growing evidence of major steps toward capital account liberalization, most obvious in the purposeful policies being put in place to internationalize the RMB. These are exactly the types of changes that are driving a rebalancing of the Chinese economy and recovery of consumption.

It is true that the Chinese authorities have not taken many concrete steps to rebalance the economy. The People's Bank of China (PBOC), for example, has not yet moved to liberalize interest rates; rather interest rates that are market-based have started to play an increasingly important role in China's financial intermediation. Policy has, however, moved to make the currency more flexible and to moderate distortions in energy markets. Changes in both labor and capital markets have also impacted positively on consumption in at least two ways. They have increased household income and reduced what were effectively subsidies to Chinese enterprises. Rising wages and interest income also advantage low-income households and should gradually help improve income distribution.

Some argue that the declines in China's external surpluses are in large part the result of a weak global economy and a modest appreciation of the RMB, not a fundamental rebalancing. The underlying drivers of the surpluses that emerged during the boom years—negative real interest rates on deposits, cheap credit for corporations, and subsidized land and input prices—are all still in place. But the pressure through the market for policy change is powerful and the current consensus is that external surpluses are unlikely to return once the global economy recovers.

Overall, the growth outlook for the big Asian emerging economies remains strong: the latest IMF forecasts are that Chinese real GDP will grow 8.2 percent this year, possibly easing back to the official 7.5 percent over the next five years; Indian real GDP will grow 6.9 percent though with a weaker outlook; and Indonesian real GDP will grow 6.1 percent with a robust outlook.

For Indonesia and other emerging economies, the focus of policy needs to be on infrastructure investment to integrate these countries more efficiently and fully into the global economy and to capture the benefits of integration. This need lies behind Indonesia's push at the G-20 finance ministers' meeting for a global initiative on infrastructure investment.

The potential for productive investment in infrastructure in the emerging economies is enormous, as I've argued before.[1] The OECD estimates global infrastructure requirements in 2030 to be in the order of $50 trillion.[2] Much of this demand is in Asia, where almost a trillion dollars' worth of infrastructural investments has already received an initial assessment from the Asian Development Bank. Despite massive infrastructure investment through the global recession and questions about its productivity, China's stock of capital relative to population and income is also low, and India and Indonesia offer vast scope for investment in infrastructure. What is needed is less government directed investment and more productive investment in infrastructure driven by the private sector.

The terms of reference of the G-20's High Level Panel on Infrastructure are too narrow to facilitate this investment and G-20 leaders need to widen the panel's terms of reference, challenging their officials, financial sector managers, and international financial institutions to use their expertise to find ways to bring more savings into commercially viable investment in infrastructure wherever it is needed, but especially in the emerging economies. Productive investment in commercially viable infrastructure in Asia's emerging economies will help to boost and sustain global recovery and present

important external opportunities for the industrial countries' businesses.

Even as the developed economies recover, Asia will continue to grow as will its share of global economic activity. The challenge of the years ahead will be to manage this global economic transition and there is nothing that will guarantee its success. For the major emerging economies, and for economies like Australia, the G-20 offers by far the best opportunity of success.

Constructing the G-20 forum represents a great achievement in international diplomacy and cooperation. But the mere existence of the forum does not guarantee a solution to the major world problems of today. What finally matters are the decisions taken by the forum and the willingness of its members to, in a spirit of mutually beneficial cooperation, follow up those decisions with independent action. The effectiveness of the G-20 depends upon entrenching the belief and the understanding that such cooperation is crucial to global prosperity and stability. There is no supra-national authority or legal framework, except through narrowly circumscribed international institutions and laws, to enforce G-20 decisions and agreements—just the power of collective responsibility and will to shape the follow-through of national actions.

The value of the G-20 to date has been the willingness of leaders to engage with the pressing issues of the day; first and foremost resolving financial and fiscal crises and their economic consequences, but also in dealing with other important economic issues like development, food and energy costs, and governance and corruption. It has not only been about talk; there has been action, albeit imperfect, incomplete and with painful lags. The challenge ahead is to consolidate and entrench respect for, and the soft discipline of, the G-20 process: to understand what it is, what the process can do, and what it can't do.

So how can the G-20 continue to make a contribution and be a political driver of change?

While the G-20 is an international forum, the economics of the G-20 is largely domestic: the focus is on delivering domestic economic growth and jobs. The G-20 represents a collaborative drive by countries for growth, recognizing from the events of the global financial crisis just how interdependent our national economies now are. This domestic focus has been to G-20's advantage; the G-20 has worked so far because it has been the highest-level political catalyst for reform, compromise and change in the leaders' own countries.

One of the G-20's successes has been the "Framework for Strong Sustainable and Balanced Growth", which embodies the basic insight that internal or domestic structural balance in the economy is the source of external balance, and that competitive and well-regulated markets, strong institutions and governance, and human and physical capital (education, skills and infrastructure) are the primary sources of a country's economic growth. The Mutual Assessment Process and action plans are the operational heart of the framework. It is essential to keep the G-20's focus on growth and employment, and that will happen by getting the basics of domestic economic policy right and through collaboration, transparency and accountability between countries. Continued growth is essential to making the global economic transition work.

Also essential is the evolution of the rules that govern and shape global economic engagement. These rules are not simply black-letter law, such as the trade rules, but include norms of behavior that make the international economic system works. The rules in the post-war period were, of course, largely written by the western powers. But they were rules that served other nations well and have been the foundation of growth and prosperity for the emerging economic powers. For much of this period, the agreed rules of international finance were written in the U.S., British, German-dominated Financial Stability Forum and Bank for International Settlements; the rules of crisis resolution and development by a G7-dominated IMF and World Bank; the rules of international trade by a G7-dominated General Agreements on Tariffs and Trade.

As the emerging market economies have grown, these rules and institutional structures have been called into question because they no longer reflect the structure of global economic power or the responsibilities that different countries need to exercise in managing the global economy. There have already been fundamental changes to governance and membership of the rule-setting bodies (of which Australia has been an active advocate), but further change in governance is needed. The formation of the G-20 itself—particularly its elevation to a leader-level forum—is a powerful example of the emerging economies' growing inclusion in global economic decision-making.

These questions about the structure and foundations of the G-20 process will become more and more important as the very process itself is challenged by the growing stress of the secondary, politically induced shocks to managing recovery and getting sustained growth on course.

This will be a time that calls for the emerging economic powers to assume their responsibilities in international initiatives as Europe and America struggle to stay on course. It will be a time to actively think about how to reinforce global institutions, like the World Trade Organization, that remain so central both to international prosperity and cooperative international politics. It will be a time for taking initiatives on new problems, such as energy security, food security, climate change and the environment. The G-20 itself cannot do all the work that will be required across these areas, but it can, and will have to, initiate much of it.

Growth in Asia and in other emerging economies may not be sustainable on the pre-crisis growth model, and Asia is slowly but surely edging away from that model. But it certainly won't be sustainable under any model unless the global rules and norms are strengthened and extended under the leadership of the G-20. The opportunity to do this is here and by grasping it, Asia and the emerging economies can help the global recovery and create a sounder basis for long-term growth.

References

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Endnotes

[1] Elek (2011).
[2] OECD (2011).