WILL THE ASIAN CENTURY REBOOT OUR DEBATE ON GROWTH?

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Will the Asian century reboot our debate on growth?

The Australia in the Asian Century White Paper is the first large-scale official look in the 21st Century at economic change in Asia and how it affects Australian opportunities and challenges.

It is ambitious as well as comprehensive.

Maybe it will reboot the Australian conversation about our country's future. Many Australians — maybe all who are thoughtful about our country's future – have been troubled by the raucous, ignorant noise that has crowded out the national policy discourse in recent years. The White Paper provides us with an opportunity to talk differently.

The White Paper's story of past and future growth and structural change in Asia is brief. This is because the paper is mostly about Australia, rather than Asia. It happens that Australian opportunity will be shaped by developments in Asia.

But it does enough to set the scene. The growth projections seem about right for the region as a whole. I won't quibble about the growth outlook for China, Japan and Korea. The projections might be slightly underdone for the countries that have been on a slower trajectory of economic growth and fertility decline, including India, Indonesia, the Philippines and Thailand. More could have been said about some other large countries which may contribute considerably to expansion of Asian output to 2025, notably Vietnam and Bangladesh.

Asian growth ascendancy – and the Australian experience

It is worth reminding ourselves in some additional ways of how sharply the fortunes of developing Asia have diverged from those of the developed world over the first 11 years of the century. The real international value of output per person (current output converted into United States dollars and deflated by the United States Consumer Price Index) fell in Japan (minus 6%). It rose a little in the United States (plus 6%). In the major European States, real output per person grew, but by less than in most similarly extended periods over the postwar period (France 49%, Germany 46%, the United Kingdom 18%.

By contrast, the international value of output per person increased over the first 11 years of the Century by 339% in China, 246% in Indonesia and 153% in India. The high-income developing countries of Asia fell into the range of the large European economies: Singapore 36% and Korea 51%.

In this League table, Australia looks nothing like other high-income countries: international value of output per person increased by 113%. By 2011, the international value of output per person in Australia stands one quarter above the United States, one third above Japan, and almost one half above the large Europeans. Only small countries with exceptional endowments had higher per capita international value of output per person than Australia: Luxembourg, Kuwait, Norway, Qatar, Switzerland and Macao.

The general story of divergence between developed country and both Asian developing country and Australian experience survives refocusing on national income rather than domestic product. The increase in Australian per capita income in real international value was a little lower, at 108% between 2000 and 2011. The fall in Japan's was smaller (minus 1%). The differences reflect incomes paid abroad from Australia and from abroad to Japan.

Japanese story

Japan's income per work-age person actually rose a little (7%) over the first 11 years of the century, a little more than United States income per work-age person (6%). The difference reflects the ageing of the Japanese population. The proportion of the population in the 15-64 years age group that is usually considered to cover the working ages fell from 68.2% in 2000 to 63.3% in 2011.

The United States ratio of people aged 15 to 64 to total population remained fairly steady. The United States and Japanese economies performed similarly in output and income per work-age person, and less strongly than other high-income countries.

Some observers see Japan's economic stagnation as a failure of the Japanese economy and polity. Many Japanese do not feel that their country is in crisis. Unemployment is low. Income is more equitably distributed than in the United States, although some Japanese are disturbed by increasing disparities. Health services are excellent by global standards and longevity incomparably high. Japanese enjoy high and subtle literacy and good education, and a rich cultural life. There is a high degree of private financial and personal security and incomparable public security — natural disasters aside.

To be sure, the ageing of the population slows national economic growth and reduces national strategic weight, and a more dynamic polity would remove some longstanding imperfections. But if Japan exemplifies the end point of modern economic growth, then modern economic growth is no bad thing.

Since the White Paper emphasises mean output, I should draw attention to a weakness in that measure of an average before we leave the comparative statistics. The mean can be held up by increases in incomes to a small number of high income people, so that it may say little about the circumstances of most people. While mean real incomes in the United States rose by about 7% between 2000 and 2011, the median income fell by 9%. The difference between changes in the mean and the median income do not seem to have been as large in other developed countries.

Missed risks around the impact of climate change

The White Paper mentions a couple of risks to growth in the large Asian developing countries, including the impact of climate change, but doesn't say much about them. My list of risks includes increasing costs of adapting to the inevitable climate change which would accompany even successful global mitigation in pursuit of the international community's 2 degree target objective. It includes the possibility of irruptions of military activity. It includes policy paralysis as a result of political tensions over policies that are necessary to sustain growth.

We see manifestations of each of these risks now in Asia. The costs of adapting to climate change are already emerging but, if the mainstream science is broadly right the consequences of substantial failure of global mitigation would be much greater later in the Asian century than in the period to 2025 that is the main focus of the White Paper.

The security risks are greatest in South Asia, where Australia has limited influence on these matters. The Paper contributes positively by declining the opportunity to repeat the naive and non-strategic talk about military conflict with China that have emanated from official sources in recent years. We have seen political tensions having negative effects on growth policy in each of the three large Asian countries this year, and they could increase in any of them, but the odds favour the avoidance of major fractures in the political fabric.

Structural change and the rise of the Asian middle class

The Paper doesn't say much at all about the large structural changes that are now taking place in Northeast Asia in particular: the demographic change that accompanies continuing low fertility (it discusses the "demographic dividend" of early Asian development but not the structural implications of the demographic implosion that is now apparent in the more advanced economies including China); the reorientation of policy towards meeting domestic demand including consumer requirements; and the higher priority that is now being given to environmental amenity, local and global, and more generally to the accompaniments of secure and prosperous human civilisation.

The Paper correctly draws the most important implication for Australia from the structural change in Asia: the increase in importance of goods and services demanded in much larger volumes by a rapidly expanding "middle class" in the high-income emerging economies of Asia. Less is said about the other side of this coin to this helpful structural change: the decline in the rate of expansion of opportunity for increased exports at high prices of the staples of the resources boom of the early 21st century, iron ore, thermal coal and metallurgical coal.

There has been much recent Australian talk of a slowing of Asian growth. Slowing Asian growth has been much less important to Australia's immediate prospects than change in the structure of China's growth. I have discussed the structural change elsewhere. It involves increased focus of demand on consumption and less on investment and exports, a higher priority for services including public health and education, and the elevation of the priority of local and global environmental amenity.

It happens that the structural change has its most severe effect on the three commodities which have been at the centre of the Australian resources boom of the early twenty first century: iron ore, metallurgical coal and thermal coal, I drew attention in my Colin Clark lecture at the University of Queensland last month to the awful reality that parts of corporate Australia had wasted shareholders' funds by underestimating the seriousness of Chinese commitments to reduce the emissions intensity of economic growth. This had led to wasteful over-investment in thermal coal mining and exporting capacity. Investment decisions had been based on the premise that the extraordinarily rapid growth in Chinese thermal coal use and imports of the immediately preceding years would continue.

New data releases have confirmed the perspective presented in the Clark Lecture. Reductions in energy use per unit of output and reductions in the emissions intensity of Chinese electricity generation have been exceeding the ambitious targets of the twelfth five year plan 2011-15. Coal-fired electricity production in August was more than 7% lower than the corresponding month of 2011.

Increased energy efficiency has been accompanied by rapid expansion of generation from all the low-emissions alternatives to coal: especially hydro, but also, wind, nuclear, biomass and solar. Coal's share of energy production was down from 85% in February to 73% in August. Naturally the impact on demand is greatest for coal imports.

The change in the trajectory of opportunity is not quite as fundamental for steel-making raw materials. For iron ore, however, we have to contend with huge expansion of supply capacity around the world, some of it encouraged by misguided Australian restriction of Chinese direct investment in this country. The optimists of the early 21st century resources boom have been and are likely to be disappointed by volume and price. Of course, price and volume interact with each other: price will have to remain sufficiently low to discourage enough production to equilibrate supply with constrained demand.

The White Paper saves its credibility on projections of demand for coal and iron ore by providing medium, high and low projections of export volumes drawn from the Bureau of Resource and Energy Economics. The credibility is protected by the presence of the low projections.

The paper correctly draws attention to expanding markets for high value agricultural produce. Here the renewed emphasis on multilateral trade liberalisation is appropriate. Australian agriculture has been damaged by the proliferation of discriminatory arrangements for agricultural trade in Asia in the early 21st century, after the breaching of the earlier Asian commitment to non-discriminatory multilateral trade.

The White Paper correctly observes that some major Australian commodity exports will benefit exceptionally from rising Asian prosperity, gold amongst them. It notes that rare earths and some other minerals in which Australia is well-endowed with resources will benefit from expansion of renewable energy and electrification of transport within an effective global climate change mitigation effort.

Which natural resources will benefit?

The White Paper could usefully have drawn a stronger distinction between minerals and energy resources that will be negatively affected by structural change in Asia in the period ahead, and those that will not, or which may benefit from the change. Uranium will benefit from Chinese and Indian expansion of low-emissions nuclear energy generation.

Natural gas will for a time be the largest beneficiary of Asian intentions to change the relationship between greenhouse gas emissions and economic growth. The uncertainty about Australia's terms of trade in the 2020s has less to do with the diminished prospects for the staples of the early twenty first century boom—thermal and metallurgical coal and iron ore—than with the extent to which sources of lower-emissions energy will be boosted by structural change in Asia.

Raising incomes sustainably

So the White Paper scene is set for discussion of how Australia makes the most of a rapidly expanding Asian economy, whose import demand is focused increasingly on high-value goods and services. The points are well made about the more demanding requirements of opportunities for export of high-skill services and manufactured goods. There is no doubting the extent of the opportunities. Our success will depend on the skills of our people, and our capacity for innovation and continuing structural change. This will require a reformed education system, much better transport and communications and energy infrastructure, a better tax system.

This is where the White Paper should be grabbing our attention.

It sets challenging goals — perhaps the most challenging that an Australian Government has ever set – of raising per capita real incomes from $62,000 now to $73,000 by 2025. The Paper says that this would place us in the top 10 countries in output per person in purchasing parity terms.

It is noted that Australia's terms of trade will fall somewhat by 2025 (and I expect them to fall further than the paper anticipates) and that ageing will slow growth in economic output. It notes that this increases the challenge of meeting the target.

Before we reject these goals as unattainable, let us consider what would be necessary to attain them, and whether their attainment would be worth the necessary disruption of temporary contemporary comforts.

Increasing average real incomes by 17% or 18% over 13 years may not sound that much. After all, we have seen that mean Australian real incomes rose by 108% from 2000 to 2011—through the tech-wreck recession in the United States and then the Great Crash of 2008 and its recessionary aftermath in the North Atlantic. What's the big deal?

The hard bit is our starting point. Our growth in average incomes over the past 11 years has been driven by two exceptional and unsustainable economic expansions, following each other with a neatness of fit that goes well beyond ordinary good fortune. By the early years of the 21st century the strong productivity growth of the 1990s had run its course.

Strong growth in economic output and incomes was sustained by the largest consumption and housing boom that we have ever known, funded overwhelmingly by overseas wholesale borrowing by our banks. We enjoyed much of the pattern and extent of growth that is now recognised as having taken Spain and Ireland and the United Kingdom and the United States into a new era of slow growth, high unemployment and social tension.

We did some things better than Spain and our fellows of the Anglosphere. We did not go so far in the removal of official regulation of the financial sector. Our authorities began to impose tighter prudential constraints before the boom conditions had reached their natural apogee. There is no doubting the contribution that economic reform over a quarter century. But for all that, the early pulling back from the consumption and housing boom was possible without recessionary consequences only because of the scale and timing of the China resources boom, with rising demand for thermal coal and steel-making raw materials at its centre.

The high incomes and expenditure after two successive booms of historic proportions define the starting point proposed for the goals on increases in output and incomes.

A "soft landing" on income

The first challenge is to come down from our hump in incomes and expenditure without precipitating recession and unemployment that will make every long-term goal more difficult to reach.

An Australian "soft landing" will require effective action on many fronts — all of them canvassed as being necessary from Australia doing well in the Asian Century. And all of these things are worth doing: maintenance of the disciplined fiscal framework within which we have been working since the stimulus in response to the Great Crash of 2008; radical lifting of education performance at schools and universities—in general and in relation to understanding Asia; providing transport and communications infrastructure in radically different ways; reforming the tax system for greater efficiency while maintaining and probably increasing the revenue yield; and more generally building a high-skill economy that responds quickly and flexibly to myriad new opportunities in Asia.

Following an Australian "soft landing" with a sustainable return to incomes growth is possible only if we remove many barriers to economic efficiency that have previously been too hard to confront. It requires us to face up to reform of Commonwealth-State fiscal relations, because the education and infrastructure problems will not be overcome unless we do. It means many hard things.

The best thing about the White Paper is that it could provide us with a framework for breaking away from the Great Australian Complacency of the Early Twenty

First Century. It may make it possible for mean Australian incomes to be 17% or 18% higher in 2025 than they are today.

But in the meantime and for quite a while, we have to hold our expenditures within the diminished constraints imposed by the end of the two great booms, and the structural change in Chinese economic growth. That doesn't mean not doing any new things; it does mean not doing new things without cutting out old ones of lower priority. That won't be easy after the doubling of average real incomes over the past 11 years. Our history informs us that it won't be possible except in a context of shared sacrifice.

But it will be worth the effort. This is the next step towards making the most of the immense opportunities for Australia in the Asian century.

It will be time to think about spending increased incomes from successful reform to hitch a ride on the Asian century after we have earned them and they are in the bank.