



## National Security College

### POLICY OPTIONS PAPER

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## The threat to the global economic and financial order: protecting Australia's interests

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### Key points

- > The international economic order reflects the balance of strategic power.
- > The challenge to the post-1945 global economic and financial order will persist as it reflects long-standing trends: perceptions of unequal economic opportunity in developed economies; the increasing economic weight of emerging economies; and the disruptive impact of technology.
- > The world is unlikely to be moving to a new or stable order.
- > The choices Western countries make, especially the US, will have as significant an impact on the future of order as the growth of the major emerging economies.
- > China's influence will continue to grow and benefit from Trump's 'America first' view of global engagement, but probably won't want to, or be capable of, supplanting the US at the centre of the global economic and financial order.

### Policy recommendations

- > Australia should focus on the institutions and fora best placed to make and enforce global economic and financial rules and most representative of relative economic power – the G20 is currently the best option.
- > Australia should also be attuned to other alignments, building partnerships and agreements with like-minded countries – large and small – on issues important to us.
- > To maintain a domestic constituency in favour of globalisation, policy will need to continue to focus on the distribution of costs and benefits and provide assistance to those that lose out.

### Protecting our interests

The institutions, rules and norms that underpin global economic and financial relations have enhanced Australia's economic security. Their preservation has long been a policy priority.

But this rules-based order is under threat from perceptions of unequal economic opportunity in

developed economies and the rise of the major emerging economies which is accompanied by a push for greater influence.

The order that evolves will ultimately accommodate the wishes of the largest and most influential economies – sometimes with views different to Australia.

This doesn't mean that new arrangements will necessarily disadvantage Australia. But it puts a premium on an adroit and flexible Australian response.

## Pressure for change

The post-1945 global rules-based economic and financial order (box below) which was shaped by the economically dominant Western powers has survived because countries are willing to trade off some independence for the benefits of adhering to global rules and norms.

This trade-off is now breaking down, and questions the very underpinnings of the order. Is its objective simply higher GDP growth? Or more equitable and sustainable growth? And what role should emerging economies play?

Moreover, shifts in the pattern and composition of trade are altering views on what are appropriate national policies to protect economic opportunity and employment, while calling into question the relevance of current rules, agreements and institutions.

Exacerbating these pressures for change are the disruptive impacts of technology on economic activity.<sup>1</sup>

### The global system

The global economic and financial order is complex and multifaceted, consisting of a dense network of formal and informal, and bilateral and multilateral rules, agreements and codes overseen by a range of institutions. These include:

- > the Bretton Woods institutions – IMF, World Bank, and (eventually) Global Agreement on Tariffs and Trade and the WTO
- > global, or multilateral institutions that were created and evolved to meet a need or crisis, such as the OECD, G20, International Energy Agency and Financial Stability Board
- > regional and subregional institutions which for Asia include APEC and the ASEAN-centred institutions and forums.

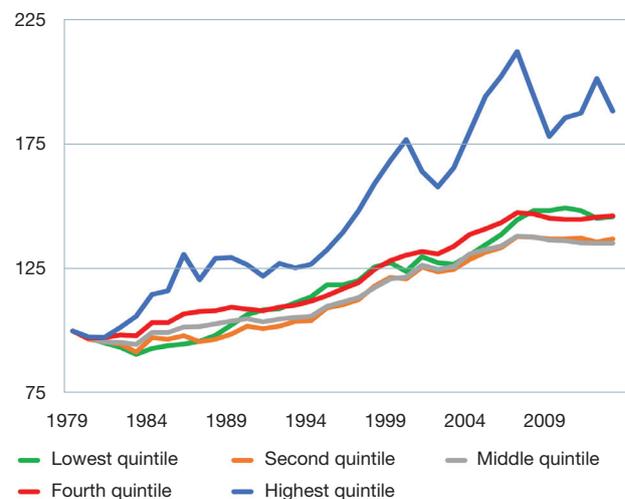
In the West there is a perception – which the global financial crisis sharpened – that the economic system has not been fair to a large number of wage earners, whose real incomes have stagnated (chart 1).

The perceived failure to respond effectively to financial crises over the last decade has eroded confidence in the political and economic elites.

This is playing out in a clash between the liberal economic framework of 'mutual gains from trade' and 'zero-sum' approaches to economic engagement, notably trade.

The election of Trump, Brexit, growing economic nationalism and a backlash against globalisation are manifestations of this perception of unfairness.

**Chart 1: US real after-tax income, 1979-2013**  
(1979=100)



Source: Congressional Budget Office, The Distribution of Household Income and Federal Taxes, June 2016

Growing economic heft amongst major emerging economies (chart 2) is inevitably leading to greater demands that their interests are accommodated. These nations believe that the existing system does not afford them influence commensurate with their economic weight. It also leaves them vulnerable to flaws in the system, as shown by the global financial crisis.

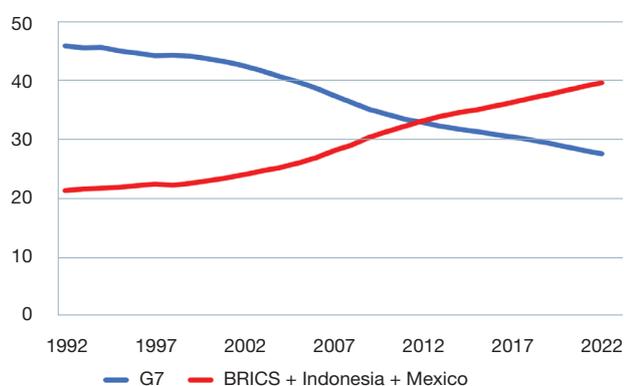
Along with domestic economic and financial imperatives, this has led them to push for greater influence in existing institutions such as the G20, IMF and World Bank; and to propose

new institutions and initiatives such as the BRICS and New Development Bank, Belt and Road Initiative, Asian Infrastructure Investment Bank and Silk Road Fund.

They have found a receptive audience in many developing economies who share their suspicion of Western-centric institutions.

### Chart 2: GDP

(Percent of World total, PPP basis)



Includes IMF forecasts

Source: IMF, World Economic Outlook, April 2017

## Economics as strategy

Global economic institutions, rules and norms have never been static. They have evolved at varying rates and not without being contested, in part because international economic institutions and norms are an expression of strategic interests as well as economic ones.

The West is confronting the reality that it can no longer shape as it had in the past the rules in ways that best serve its interests. How it responds to the diffusion of economic power will have a big bearing on how the order evolves. Strategic rivalry between the West and the major emerging economies (particularly the Sino-US relationship) threatens to stymie cooperation on a way forward.

## Leadership vacuum

A domestic backlash against globalisation is threatening the US' willingness to maintain the responsibilities and compromises needed to lead the order – seen in the US withdrawal from the Trans-Pacific Partnership, Paris climate agreement and renegotiation of trade agreements.

But other countries are unlikely to be in a position to fill the void. Collective responses reveal an unwillingness to go much beyond more influence, such as a beefed-up BRICS grouping. Meanwhile, the EU or China do not want (or lack the requirements) of exercising global leadership.

Even if individual states did put themselves forward, they are likely to encounter resistance. For example, China's economic diplomacy push arouses suspicion in many Asian countries, including India and Japan. And even outside China's Asian neighbourhood, such as in Europe, countries are concerned about losing economic competitiveness.

## Implications for Australia

The global economic and financial order is likely to become less cohesive and more contested, and with competing institutions, rules and norms. In this environment, states will become even more transactional in their relations with others, making it harder to reach global agreements, including in responding to economic and financial crises.

For Australia, it will be important to try to protect what we value most from the order. Priorities include:

- > the multilateral trading system and access to markets
- > participating in multilateral fora that allow Australia to enhance or entrench its influence, while providing a collective response to crises
- > preventing countries using economic tools for strategic objectives.

To protect these, we should focus on institutions and fora best suited for rule-making and rule-enforcing. Such an institution or forum should:

- > include all the economies powerful enough to set and enforce rules
- > be representative of relative economic strength, thereby removing some of the incentives for creating alternative or parallel institutions or rules
- > have a broad enough membership to limit dominance by the most powerful
- > be attuned to addressing issues that erode popular support for global institutions.

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The G20, despite struggling to contain the proliferation of initiatives, is currently Australia's best option to influence international economic norms. And regional economic institutions are taking on greater strategic significance, such as the Asian Infrastructure Investment Bank.

But as well as supporting our preferred institutions and fora, to give us the best chance of prosecuting our interests, we should also be attuned to building partnerships and agreements with like-minded countries on issues important to us. This suggests continuing to work in groups such as the Cairns Group of agricultural exporters which Australia was instrumental in establishing.

There are limits to what middle powers can do to shape the economic rules-based system. But Australia does have influence and credibility.

Australia pushed strongly for the G20 and was instrumental in creating APEC, as well as providing a template for developing Asian countries on economic reform. And Australia is seen as a consistent advocate for open trade in multilateral and regional trade negotiations.

Australia has done well compared to the US and Europe in limiting domestic anti-globalisation sentiment and pressure

for protectionism. This is due partly to redistributive policies designed to moderate inequality, and partly to the substantial positive wealth effects from strong growth in Asia.

To maintain a domestic constituency in favour of preserving as much of the global economic and financial order as possible, we will need to continue to respond effectively to negative side-effects – such as the impact of globalisation and technology on economically non-diversified communities.

This puts a premium on focusing on the distribution of costs and benefits and providing assistance to mitigate negative consequences.

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## Endnotes

<sup>1</sup> There is a complex relationship between technological change and globalisation, and the impact on employment, wages and income inequality. Simply, technological change encourages the substitution of capital for labour (especially at low and mid-skill levels) while enabling global supply chains to source lower production costs. For a brief discussion of this relationship see Laura Tyson 'Labor Markets in the Age of Automation', Project Syndicate, June 7, 2017 available at <https://www.project-syndicate.org/commentary/automation-labor-market-inequality-by-laura-tyson-2017-06>

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## About this publication

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