



**National Council of Applied Economic Research
&
Australia-India Council**

The Fifth Sir John Crawford Lecture, 2008

**Australia, India and Asian Integration:
Building upon the East Asia Summit**

Peter Drysdale

Crawford School of Economics and Government
The Australian National University

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Dr Jalan, Suman, distinguished guests

It is a huge honour to be invited to give this lecture this evening.

Sir John Crawford was a great Australian who made an immense contribution both to Australian and international public affairs.

I had the privilege of working closely with him for the last 25 years of his life. In the early 1960s, he recruited me as a graduate student to the Australian National University to work on Australia's relationship with Japan. Crawford was the architect of the postwar relationship with Japan, a relationship that he helped fashion despite the bitterness of the war. Before the war, as a young man, he articulated a vision, and a role, for Australia in Asia that foretold of an economic and political compact that later underpinned the idea of an economic community in Asia and the Pacific and the development of APEC.

When he died, your then Prime Minister, Indira Gandhi, wrote a letter of warm appreciation for his contribution to India's great agricultural reforms, a letter which I read to the memorial service held in Canberra in Crawford's honour. This lecture is acknowledgement of that contribution and his long commitment to working with colleagues here in India on issues of importance to development.

To deliver this lecture in tribute to this man - whose achievements are still deeply appreciated in this country and elsewhere and who was my mentor in all things - is a particular and personal pleasure.

When I was a child in Australia before the Second World War, I and my siblings were cared for, and pampered, by an Indian family who had a sub-lease on my father's very small and uneconomic farm in the northern bush. So, although I have come only recently and infrequently to India, my childhood made me part of the Indian family. This experience adds special warmth to your welcome this evening.

Australia and India have much that we share. We have a common heritage from the imperial past, institutions, law, and democracy. Though suddenly last Australian summer there were some doubts, we continue to enjoy the cricket. These things are derivatives of the past.

What is the promise of the future? Tonight I shall suggest to you that India and Australia are on the cusp of an historic opportunity for sharing a new, much more important relationship in the future than we have shared in the past.

Australia is already deeply integrated into the East Asian economy. Australia's external economic relations are more closely tied to the East Asian economy than are those of any other country in the world. The whole structure of our interests in global economic and political affairs was changed fundamentally over the past four or five decades by the development of our relationships with Japan and East Asia.

India has embarked on a great externally-oriented reform. The scale and the nature of forces that are driving India's involvement in the global economy are also deepening integration across Asia. This huge process in which India and Australia are both now engaged in the Asian economy, from different ends, will inexorably draw us more and more closely together.

This is a strategic opportunity, and to capture it is important not only to Australia and to India but also regionally and globally.

The direct imperative that will shape the future of the Australian and Indian partnership in Asia is the deep complementarity between our two economies. Already that is having its impact on the growth and importance of our bilateral trade and investment.

Let me deal with that first.

Australia's trade and economic relationship with India is now one of our fastest growing. In the past five years commodity exports have increased fourfold and last year alone Australia's exports to India rose by 37 per cent. India is already Australia's second largest market for metallurgical coal and is a huge potential market for energy, including uranium. But there is more to the relationship than the resource trade. The rapid growth of services trade both ways, as Australia educates Indian students and entertains Indian visitors in growing numbers, and migration are new and major elements.

What is now happening between Australia and India, is the emergence of a trade pattern that is well established in Australia's relationships with East Asia. The trade relationship with

Australia is also strategically important to East Asia. Australia alone supplies around half of Northeast Asia's key imported industrial raw materials and more than 22 per cent of Japan's energy supplies (not including uranium) - Australia is a more important energy source for Japan than is Saudi Arabia. These are large, deep, reliable relationships, critical to the prosperity and stability of the entire Asian region.

India's continued growth and industrialization is forging a relationship between Australia and South Asia that, 10 or 20 years hence, is likely to match the well-established relationship with East Asia.

All this is changing fundamentally the stature of our bilateral relationship and the priority that it must now attract. The context of that change is the emergence of the Indian economy and the opportunity for integration of the South and East Asian economies, including Australia.

What policies and strategies are important to the successful realization of this historic opportunity? What arrangements do we need to put in place with our partners in Asia to help better secure it? These are the questions about which I would like to share a few ideas with you this evening.

Integration in Asia

The underlying forces driving the growth and changing structure of the Asian economy are a product of developments in national markets and the national policy choices that have made them perform more efficiently and enjoy faster than average economic growth. These policy choices led to momentous economic and social change in Asia, change that continues to have a huge impact on the structure of the regional and global economy. The nature of the big East Asian economies, including Japan and China, with their heavy population densities and limited resource bases, meant that their successful industrialisation and development depended on integration into the international economy. An open international trade and economic policy regime and high levels of dependence on international trade and capital have played, and continue to play, a critical role in Asia's economic transformation (World Bank, 1993).

India now faces the same challenge and happy prospect.

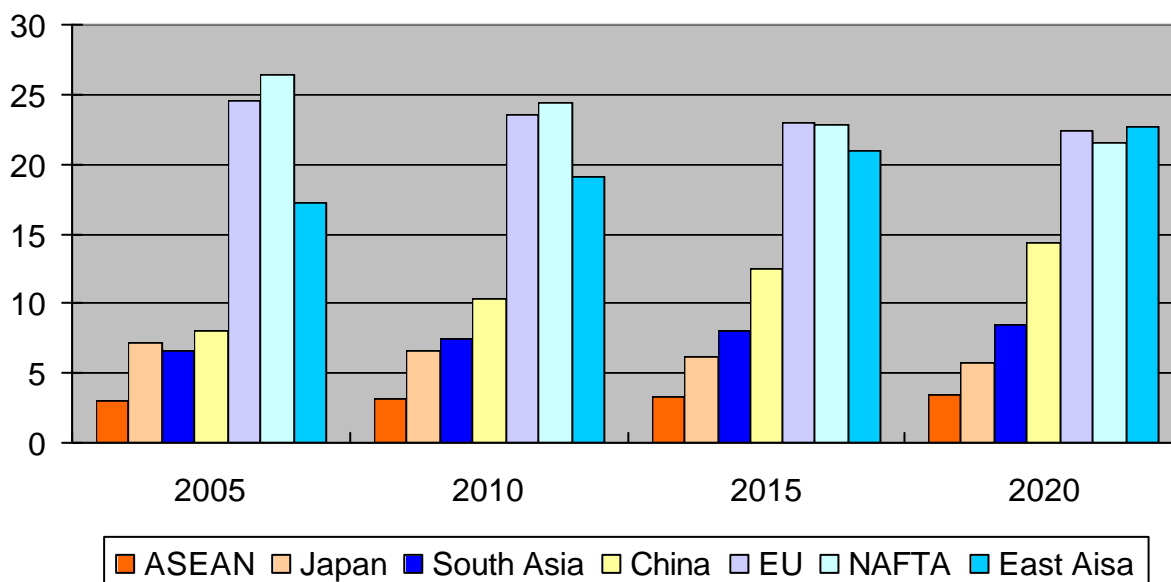
A key theme that I want to stress here is that what is going on in the Asian economy not only lifts Asia's role in the global economy but also vastly elevates Asia's responsibilities in international economic affairs. This might seem a trite observation. But it is one the import of which is little appreciated. A central interest is in managing the rise of Asia's economic power and its impact on established power. A central task for regional arrangements therefore is to strengthen Asia's capacity for delivering on its new global responsibilities.

Dominating developments in the Asian economy is the impact of the growth of China and India. Embracing the rise of China and India presents both economic risks and economic challenges. Building a regional architecture and institutions that will sustain growth and deepen international integration while also managing any accompanying risks of economic or political instability on global systems is a major priority.

Transformation of relative economic power

Measured in purchasing power parity (PPP) terms, even with the recent downward adjustment of Asian real output released by ADB (ADB, 2007), Asia's share of global GDP will amount to around 31 per cent in 2020, of which China alone will account for over 14 percentage points (see Figure 1).¹

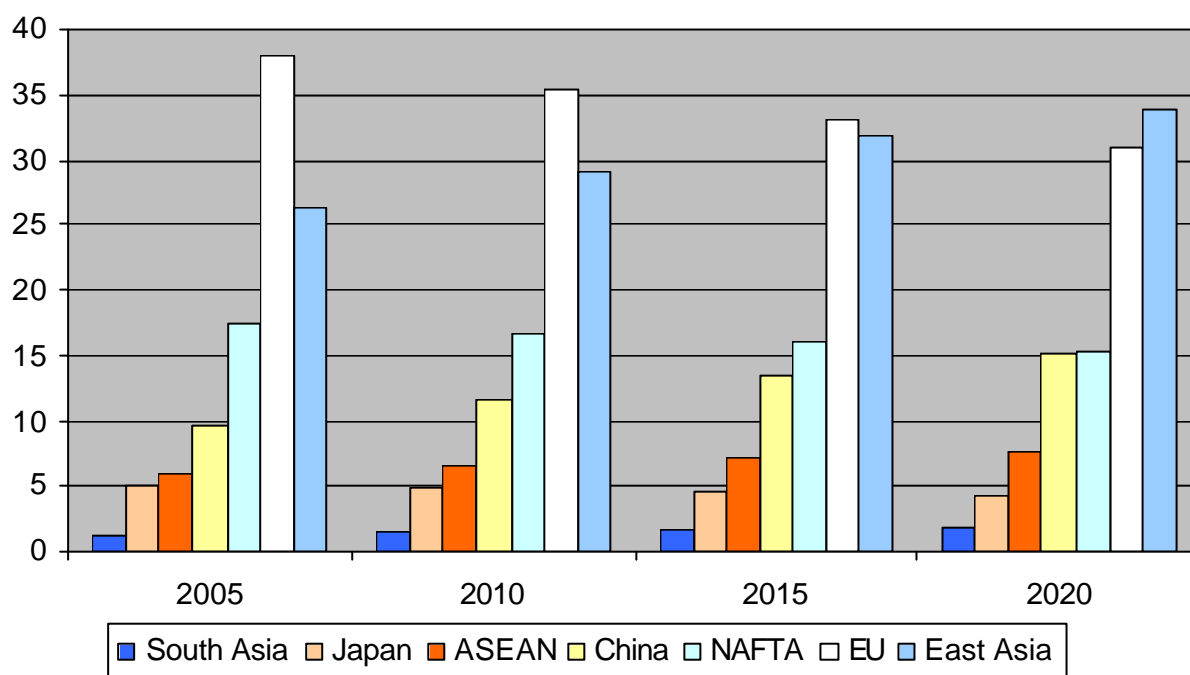
Figure 1 Projected World Output Shares at Purchasing Power Parity, per cent



¹ These projections suggest that China and India will have an impact on the world economy substantially larger than that projected in the World Bank Report *Dancing with Giants*, where more conservative growth rates were assumed at constant prices to initial output shares. The case for using PPP data rather than initial market exchange rate data to project the future structure of world output rests on the likelihood that substantial exchange rate appreciations in rapidly growing economies (such as China) will more accurately reflect their weight in the world economy 15 years hence (Winters, 2006: 5, fn 7).

The scale and weight of income growth in Asia, of itself, will have a huge impact on trade in goods and services both globally and within the region. The income growth projected here could not be sustained without continuing to maintain the openness to international trade and private capital flows that has helped to drive successful growth in the past. Increased incomes in the Asian economy will lift the importance of Asian trade in world trade; the Asian share in every country's international trade will grow, on average, commensurately with Asia's growth

Figure 2 Projected World Trade Shares by Region, per cent



in world trade share. For some economic partners, such as the Asian economies (including Australia²) themselves, proximity to the region and the complementarity of their economic and trade structures will intensify intra-regional trade and investment ties as Asia experiences deeper integration with global markets.

The projections I have developed here - based on conservative Asian GDP and trade growth rates, and incorporating a contraction of the US current account deficit and the effects of a tax on trade in carbon generating products - lead to an Asian share of world trade of 36 per cent compared with a North American share of 15 per cent in 2020. East Asia's share of world trade, under these assumptions, is 34 per cent, larger than that of North America and even Western Europe (see Figure 3). China's is close to 15 per cent – more if China's trade is measured to include Hong

² Australia is the most Asia-oriented economy defined in the world in terms of its trade share going to, and derived from, Asian economies. In the projections reported here, East Asia includes Australasia.

Kong net of intra-Hong Kong–China trade. On these projections, India will still be performing under its merchandise trade potential a decade or so hence.

Looking ahead in this way highlights the potential of the Asian economy. It spells out the arithmetic of what happens when there is growth of big concentrations of output that are proximate and complementary to each other. It also highlights the huge shift in relative economic power that is taking place between Asia and the other major centres of world economic power.

Institutions and Integration

Integration is not an end in itself but an outcome associated with achieving better national economic performance. At the deepest level, beneficial integration into the international economy requires not only openness at the border for trade, investment or financial flows, but also good domestic microeconomic and structural policies as well as sound domestic economic institutions. Good microeconomic policy is at the heart of the process of domestic reform and liberalisation that delivers better economic outcomes and drives effective international integration, both in real and financial markets. In seeking remedies for the under-realisation of trade and investment potential as well as superior strategies for economic integration, we need to look at, but also well beyond, trade and trade policy (or border) measures and focus on domestic reform and liberalisation (behind-the-border) measures. Domestic reforms that strengthen commodity, financial and factor markets through increased competition and efficiency now have much more important effects in promoting growth through economic integration than traditional trade policies at the border (Dee, 2007).

Whatever way you measure the potential for improving trade and economic performance, the progress that has been achieved in India over the last decade and a half has been remarkable. Yet there is still a long way to go. South Asian global trade is estimated to be at a level that is less than half its potential given the scale and structure of the economy. East Asia, including China is much closer to achieving its trade potential than South Asia, including India (Armstrong, Drysdale and Kalirajan, 2008).

This is a challenge primarily for national policy and for India as global player. But national and global efforts can also be assisted by regional cooperation.

What shape might an Asian economic community that seeks to promote reform, growth and help manage growing regional interdependence in a global context eventually take?

Regional goals and global interests

While Asia's institutions for economic cooperation might appear underdeveloped, regional arrangements for policy dialogue are evolving rapidly. An expanding network of forums, groupings and contacts, formal and informal, bring the region's leaders, officials, businesspeople, researchers, and civil society together. The main established groupings are ASEAN, ASEAN+3, the EAS (ASEAN+6) and APEC. They are distinctive, but they need to be developed as mutually reinforcing elements of the wider regional economic architecture.

Figure 3 maps the membership of the three main regional arrangements across Asia and the Pacific, with their overlapping boundaries centred on ASEAN.

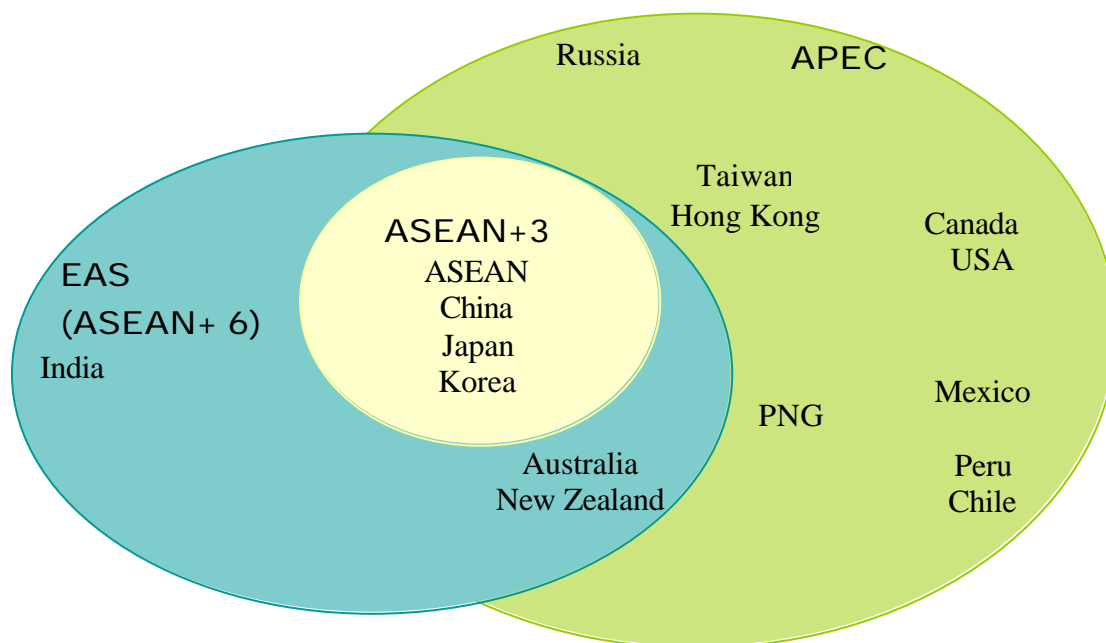
Figure 4 describes the issues on which each arrangement has primarily focused and provides a picture of how their cooperative activities complement each other.

Asia's growing weight and importance in the global economy requires that regional arrangements be shaped with global objectives and interests in mind. Asia's best choice is a choice of arrangements structured to help it deliver on its global interests. The major Asian powers are already such important global economic players that the way in which they pursue trade and investment objectives, their financial systems, and the effect of their growth on the environment all have global ramifications and need to be negotiated globally.

An outward-looking, open Asian regionalism is needed to reconcile the twin aims of fostering closer regional integration while deepening connections to the global economy. Asian regionalism is more likely to succeed if it is encompassed within a framework of international organisations that strengthens the region's capacity to exercise leverage globally and encourages continuing engagement with America and Europe, and globally in multilateral negotiations. It will fail if it takes a narrow, inward-looking, defensive path. The global framework sustained East Asian integration over many years, both economically and politically. The biggest economic relationship in East Asia - that between Japan and China - prospers, despite the ups and downs in bilateral political relations between the two Asian economic giants, because it is embedded within the framework of global commitments (Drysdale, 2008). That is the way forward for China and Japan in an Asian economic community. It is also the way forward for the other economies of East and South Asia.

Certainly the evolution and success of Asian economic cooperation will not ultimately stand or fall on negotiation of a preferential trade agreement: it will stand or fall on whether it develops within the framework of robust global trading arrangements. These are the institutions that promoted intra-regional trade integration in East Asia. They are the institutions that will secure its future.

Figure 3 Regional Architecture and Membership

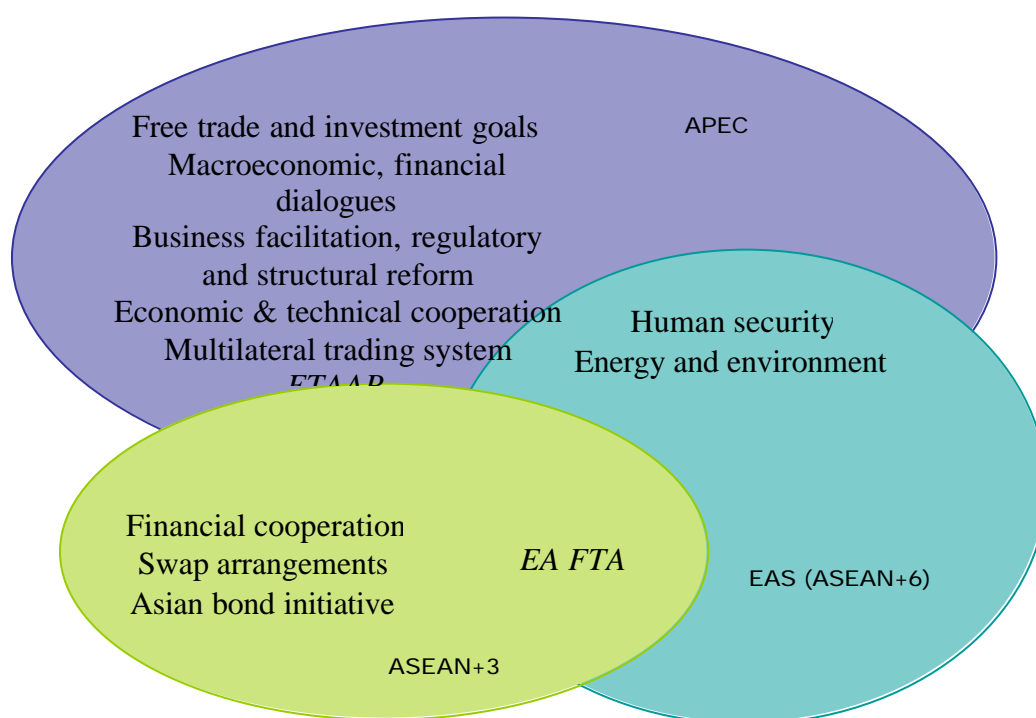


Note: Not all individual members of ASEAN are members of APEC but the core ASEAN membership, including the ASEAN five and Vietnam, are included and ASEAN collectively plays a key role in APEC.

Regional economic architecture

Must an East Asian Community compete with growth of trans-regional cooperation with South Asia? Or can it be sensibly structured so as to incorporate and strengthen trans-regional cooperation across Asia and the Pacific? It will be clear that in my view an open and inclusive strategy is likely to serve Asian objectives best.

Figure 4 Regional Architecture and Agendas of Cooperation



Note FTAAP and EA FTA are policy strategies under consideration in APEC and ASEAN+3 and EAS respectively.

Despite the locus of East Asian community-building interests in ASEAN and ASEAN+3, many of the challenges the Asian economies confront can only be met – or at least met best – by regional institutions that comprehend trans-regional and global interests. Asia’s rise is a global phenomenon and the region needs strategies that are globally oriented to manage the response to it. The systemic stresses associated with the rise of Asia will be managed more readily if there is a regional framework in which China and India can develop a common regional voice on both economic and political affairs.

This is why the incorporation of India in the EAS was important, not as a diplomatic tactic but because it provided a critical platform for strategic economic cooperation between India, China, Japan, Southeast Asia and Australasia.

On all the big global issues that beg coherent Asian initiative - dealing with climate change, reforming the trade regime and international financial system, promoting deep structural reform and global integration - the broader framework for cooperation in the EAS alone is capable of effective delivery. As yet there is no effective Asia coalition for negotiating these issues. The EAS is a platform for building one.

Is India ready to assume its global responsibilities and play a proactive role in that?

The huge shifts in the structure Asian power have political and security dimensions as well as economic dimensions, and the structure of regional institutions needs to address them. This is the logic on which APEC was built, as it sought to accommodate the rise of Japan and East Asia. It is also the logic for India's engagement in the EAS and for incorporating India into APEC, on terms that other APEC members have accepted.

Globalisation and the rise of *ad hoc* economic and political bilateralism have taken Asia further than ever from the European model and towards a new model of integration in our region. East Asia already has higher levels of trade and investment integration than Europe achieved over twice as many decades.

The imperative is to deal strategically with the global pressures that challenge Asia's economic rise. In the coming decade this imperative will grow more intense. An Asian regionalism that fosters a regional economy that is internally integrated, closely connected with North America, Europe and other international markets, and assumes a responsibility and influence in global economic arrangements more commensurate with its new economic weight will bolster both Asian and global welfare and lessen the attendant risks in global trade and economic transformation.

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