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New Alliances: Australia and Europe in a G20 World

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New Alliances: Australia and Europe in a G20 World

Alastair Walton*

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Abstract

This briefing paper contains the text of the Robert Schuman lecture, given by Mr Alastair Walton on 23 May 2012 at the Australian National University. The annual lecture celebrates the remarkable achievements of European integration since its modest beginnings in the European Coal and Steel Community in 1951, announced in a declaration by French Foreign Minister Robert Schuman. The 2012 lecture noted that in an increasingly globalised world, Australia's long term prosperity relies on its ability to maintain a highly productive, flexible and open economy. Effective relations with the world's economic powers are therefore paramount. Arguably, the European Union is the world's leading soft power. The lecture substantiated that it is in Australia's interest to take a whole of government approach to influence European thinking, as well as build Australia's national brand in Brussels and Europe's other capitals to better harness and influence the direction of European soft power in support of Australia's strategic needs. The efforts of former Prime Minister Kevin Rudd and Ambassador to the EU Brendan Nelson have fundamentally shifted Australia's approach to Europe and are evolving Europe's often misguided understanding of the Australian economy. Australia should continue to build on the momentum of this new phase of the relationship by pursuing an ambitious bilateral agenda, including the negotiation of a comprehensive Free Trade Agreement, commissioning a white paper on Europe's influence in global affairs - including the various Europe-based multilateral agencies -, the appointment of an Ambassador for Europe, and undertaking a review of financial

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and operational resources in Australia's key international agencies, specifically DFAT, Austrade and Ausaid.

Schuman Lecture

Professor Jayne Godfrey, Dean of the College of Business and Economics, Professor Jacqueline Lo, Director of the Centre for European Studies, Ambassador David Daly, Your Excellencies, Mr Peter Grey, CEO of Austrade, distinguished guests, ladies and gentlemen.

As an alumnus of the Australian National University and its Economics Faculty, it is a great privilege for me to deliver this lecture in honour of one of the founding fathers of the European Union, Robert Schuman, the German-born French Foreign Minister. Not only did Schuman serve France with great distinction, his vision for a united Europe remains an enduring legacy, as was his instrumental role in the foundation of NATO.

Before my formal remarks, I would like to acknowledge my sister Catriona Mackenzie who is a Professor of Philosophy at Macquarie University and who undertook her PhD at the ANU in 1992. Also I have pleasure in acknowledging my friend Helen Baxendale, an ANU University Medallist who is currently teaching at Canberra College under the Teach for Australia Program.

Alas an ANU PhD or University medal eluded me, but at a recent dinner in Sydney the NSW Premier Barry O'Farrell, who was also politically active during his time at ANU, advised the audience that I had won the University Iron Man competition, although this is still a matter of controversy! I suspect that this will be the first lecture ever given by a former ANU Iron Man, hard as that is to believe looking at me now.

During my time at ANU the core teachings that framed my understanding of global economics is that in the conduct of international trade and investment, small countries such as Australia are price-takers and have no pricing power in global markets for their goods and services. That is to say, Australia's terms of trade are dictated by the actions and activities of large economies, which is borne out by an analysis of Australia's trade performance over the past half century, including our wool and mineral booms.

At the time I was at the ANU, Australia had an economy based on high tariffs and a rigid mechanism for setting national wages, colloquially known as the 'Industrial Relations Club'. Wage negotiations were principally informed by projected levels of inflation and rarely linked to changes in national productivity.

Professor Peter Swan and other leading academics at ANU's Economic Faculty argued that this was economically irrational and the only way to sustain long-term national growth was to eliminate tariff barriers, deregulate the labour markets and build a highly productive, flexible and open economy.

I have always thought that the small country/price-taker theorem was applicable to many aspects of Australian life and is particularly relevant in the areas of defence and foreign policy.

In 1942 Australia was saved from possible invasion by one larger power – Japan – by the timely intercession of another – the United States – whose entry into World War II came at a critical time when the futures of both Australia and Europe hung in the balance.

At the end of the war America's economic and industrial output represented approximately fifty per cent of global GDP. This economic might was successfully harnessed for the massive task of rebuilding a devastated Europe known as the Marshall Plan. Further, the Lend Lease Agreement between the United States and the United Kingdom saw our American ally gain naval bases around the world and become the world's pre-eminent naval power.

In Australia, the establishment of the ANZUS treaty in 1951 has formed the cornerstone of our defence and security arrangements which endure to this day. Since the shock of World War II and particularly the war in the Pacific, Australia's political and government leaders have worked assiduously in a bipartisan way to cultivate and nurture our relationship with Washington. Political leaders in Australia clearly understand the vital importance of our strategic alliance with the US.

Australian political leaders are also expected to engage in our region and build strong relationships with their counterparts in Beijing, Tokyo, Seoul, Jakarta, Singapore, Wellington and in the Pacific with a combination of friendly openness but also an assertiveness befitting Australia's status as a 'middle power'.

Australia's sheer land mass and strategic location, successive immigration waves from both Europe and Asia, strong democratic institutions and legal framework, highly performing economy and its alliance with the US means that it is a small country which has far more regional and global significance than its population alone should warrant.

There is no doubt that Australia has successfully engaged with its Asian neighbours and has come a long way since the dismantling of the White Australia Policy, the adoption of multiculturalism, the opening of the Australian economy, becoming a reliable and secure supplier of minerals and other resources to Japan, China and Korea, educating generations of

Asian leaders, supporting democratisation and peacekeeping in Asia, and playing a leading role in the formation of the G-20.

Despite our increasing engagement and friendly relationships within the Asian region, the unfortunate fact is that, over the coming decades our own defence and military capabilities are going to be overshadowed by those of China and India.

The United States will be of critical importance to our region's stability in the decades ahead and for the foreseeable future the US, with its massive naval and military capability, will remain the only 'hard power' in the world able to maintain open sea lanes which are essential to global trade. But one thing is certain, the dynamics in the region are changing and we cannot assume that the path will be a straightforward one. In this regard, Australia cannot rely on US 'hard power' alone for its security.

From a strategic perspective things are going to get a lot trickier for Australia in the 'Asian Century' and Australia will have to be increasingly nimble in managing its relationships with China and across the region. In a recent article the Executive Director of ASPI (Australian Strategic Policy Institute), Peter Jennings, wrote:

'We are not about to be attacked, but the region looks less stable: US-China relations are developing a harder edge to military competition. China, Japan, India and other Asia-Pacific countries are vigorously modernising their forces.

The potential for at-sea confrontations over resource claims in the South China Sea is rising. Space and cyberspace are tense, contested domains with little international agreements on how to curb aggression.

There is no more vital strategic interest for Australia than to ensure the US remains deeply engaged in Asian security. It escapes no-one in the region that a large rotational US Marine and Air Force presence in Australia's north would massively complicate an adversary's plan to do us harm.'

Australia will also need to re-think its geopolitical alliances beyond its 'hard power' relationship with the United States and regional engagement with Asia, to significantly upgrade its relationship with the world's largest economy and the leading 'soft power' in global affairs – the European Union.

The proposition I wish to make in this lecture is that Australia's relationship with the European Union must be seen as strategically important as those with the United States, China and Indonesia. The dynamics of this relationship and what underpins it need not only to be well understood across the political divide but also resonate with the public at large. The Australia-EU relationship must be viewed as 'core-business' for any Australian leader.

Let me explain what I mean when I refer to Europe as the world's leading 'soft power' and why it is so important to Australia's future.

Over the past sixty years, Robert Schuman's vision of building European unity has been secured through the creation of a common market and the building of common institutions. The European Union has evolved into the world's largest single market comprising 27 Member States, 500 million consumers, a combined GDP of just over \$US 17 trillion and a common currency, the Euro, in 17 Member States.

European 'soft power' is derived from the interaction of different elements. The term 'soft power' was first coined by Harvard academic Joseph Nye in 1990 and was later referred to by US Secretary of Defense Robert Gates as 'the civilian instruments of national security - diplomacy, strategic communications, foreign assistance, civic action and economic reconstruction and development.'

Arguably the European Union is the most successful political institution in the world to make use of 'soft-power', backed by its economic size and diversity, history and cultural institutions, and successive waves of enlargement which have brought democracy and freedom to peoples formerly behind the 'iron curtain'.

In July 2013, Croatia will become the 28th Member State of the EU, with Serbia, Montenegro and the Former Yugoslav Republic of Macedonia having been accepted as official candidates for membership. Little more than a decade ago, the Balkans were emerging from yet another bloody conflict in the history of the peninsula. The prospect of EU membership has brought with it the possibility of lasting peace and the bringing to justice of those responsible for terrible war crimes.

Europe has also been the founder and remains the home of a multitude of globally-respected institutions, from those engaged in the promotion of democracy and human rights to those regulating trade, labour, and environmental standards – the WTO, OECD, the ILO, OPEC, and the WHO, to name a few. In July this year the world will once again focus its attention on the summer Olympic Games in London.

Europe's commitment and institutional capacity to advocate democracy, the rule of law and human rights promote the same shared values as we hold making Europe our natural ally as we confront the challenges that will inevitably arise during the 'Asian Century'.

I would like to develop the concept of European 'soft power' as it relates to the regulation of business globally. As the largest single market in the world this has had a profound influence, for better or for worse, on global regulatory standards.

The Economist noted in September 2007:

‘Brussels is becoming the world’s regulatory capital.

The EU is a big market, with almost half a billion consumers, (but) neither size, nor zeal, nor sneaky protectionism explains why it is usurping America’s role as a source of global standards. A better answer lies in transatlantic philosophical differences.

The American model turns on cost-benefit analysis, with regulators weighing the effects of new rules on jobs and growth, as well as testing the significance of any risks. In Europe corporate innocence is not assumed.

Yet the more proscriptive European vision may better suit consumer and industry demands for certainty. If you manufacture globally, it is simpler to be bound by the toughest regulatory system in your supply chain.’

2012 marks the 20th anniversary of the European single market. While this is far from complete, Europe has been economically transformed by the ‘four freedoms’ of the internal market – the free movement of goods, capital, services and people across national borders. The EU is now a single marketplace comprising a population 20 times that of Australia and an economy more than 10 times ours. Whilst COAG (the Council of Australian Governments) is now making good progress towards a so-called ‘seamless’ national economy, the scale of that enterprise is rather modest when compared to the building of the European internal market.

Europe is also the largest donor of overseas development assistance, providing more than half the world’s aid. It is the second largest donor to the Pacific after Australia.

Modern Australia has been founded on European immigration and European capital. Approximately 70% of Australia’s population is of European descent and with an investment of \$650 billion, Europe is the single largest investor in our economy, providing a third of all foreign investment. Europe is closely followed by the United States at \$550 billion, so in total around 60% of all our foreign investment is sourced from the EU and the US.

On the other hand, China is now Australia’s top trading partner, having overtaken Europe some years ago. Yet this is only part of the picture. Europe remains our top trading partner in services, and Chinese investment in Australia is only around 1 to 2% of the whole, although with enormous growth potential.

Having looked at the critical importance of the US alliance to Australia’s security policy, Europe’s role as the global leader in ‘soft-power’, and the predominance of European and US investment in Australia, it is also interesting to reflect on the vital nature of the relationship between Europe and the United States itself.

In macro terms, Europe and the United States combined still account for over half of global GDP. Europe and the US are each other's largest source of foreign direct investment and together they generate around three quarters of global financial services, around a third of global trade, and almost every other country in the world counts either the EU or the US as their top trading partner. Further of all Fortune 500 global companies, as ranked by revenue, the EU has 148 companies, the US has 133, and Japan and China combined have 129.

The global financial crisis has abundantly illustrated the inter-connected nature of global business and the financial markets which is clearly apparent in the integrated nature of the transatlantic political and economic relationship between the EU and the United States. What it means to us in Australia is that our most important defence and security ally and second largest investor - the US - and our most important foreign investor and second largest trading partner - the EU - are totally connected with each other economically.

Australia's relationship with the United States is well served by a plethora of organisations covering a wide spectrum of government, economic, business, and research dialogue. For example, the Australian Government has made an endowment of \$25 million to fund a US Studies Centre. Further, the annual Australia American Leadership Dialogue is seen as a vitally important part of the bilateral relationship bringing together current and future political, business and policy leaders.

Many members of the European Australian Business Council (EABC) are also members of the Australia-American Leadership Dialogue and are active participants in its programmes. There is a further overlap with many participating formally and informally with business and government relationships encompassing China, Japan, India and other countries in Asia.

In my view, the magnitude and dimensions of the Australia-Europe relationship are of such importance in the 'Asian Century' that a complete strategic re-think is required by the Australian Government and the business community.

Australia has been very slow to recognise, understand and react to the profound changes occurring within the EU over the past decades, and its likely further evolution in the decades ahead.

Firstly, there will be an increasing concentration of power and influence in the European institutions including the European Council, the European Commission, the European Parliament, the European Central Bank and the European Court of Justice.

Secondly, the increasing political and economic influence of non-European G-20 countries will mean that European 'soft-power' will be increasingly exercised by agencies at the EU-level with

the capacity to do so – including the new European External Action Service, which is jargon for its diplomatic corps.

Thirdly, EU Member States will have no option but to adopt further internal market reforms, fiscal centralisation and consolidation at the EU level.

In my view, Australia has a poor understanding of the core philosophical underpinnings of this European unity and the choices European leaders make in support of this which often does not appear to be economically rational from outside. Further, there is no doubt that Australia's political class as a whole has not thought through the benefit of working closely with European counterparts in attempting to influence the direction of EU policy in the decades ahead.

For too long Australia viewed its relationship with Europe from the narrow prism of agriculture and the Common Agricultural Policy. The European Australia Business Council of which I am the Chairman was established with the support of the European Commission in 1999 and has grown to become an organisation with annual revenues coming close to a million dollars a year and a Board of Directors comprising some of the most influential business and policy figures in Australia.

The intellectual framework for the EABC was actually established by an American, none other than Wall Street guru Abby Joseph Cohen who on her first visit to Australia in 2002 posed the question:

‘Why does Australia view its relationship with Europe almost entirely from the prism of agriculture when it represents only 2% of your GDP and Europe as a whole is your largest economic partner? It makes absolutely no sense to me.’

Members of the EABC represent a broad spectrum of business, government and social leaders including the Group of Eight Universities. Our perspective is that while agriculture is a very important contributor to the Australian economy and represents around 12% of total exports of goods and services, it should not distort the development of our relationship with Europe. The United States also provides subsidies to its farming sector but this has not been an impediment to our ‘special relationship’, nor to concluding a Free Trade Agreement in 2005.

That said, it is important to recognise that things are changing and quite rapidly. The visit by Kevin Rudd to Brussels at the commencement of his term as Prime Minister was a strategically important step. Further, his decision to appoint the former Leader of the Opposition and Defence Minister Dr Brendan Nelson as Australian Ambassador to the EU and NATO was inspired.

In 2006 I led the first ever mission of Australian business leaders to Brussels. What shocked the delegation was that our interlocutors in Brussels were actually expecting us to be angry farmers who had come to discuss agriculture and the Common Agriculture Policy. It was very clear to us that there was very little real understanding at the European Commission about the strength, depth and diversity of the Australian economy nor of our 25 years of economic reform.

The question that I posed at the time was, ‘Well whose problem is this state of ignorance, the European Commission’s or ours?’ My thoughts went right back to Professor Swan at ANU. As a delegation representing a small country/price-taker, it was clearly our problem.

Six years later I had the honour of hosting the President of the European Commission Jose Manuel Barroso at an EABC lunch in Sydney which was the first such visit to Australia in thirty years. I am advised that upon his return to Brussels, President Barroso spoke enthusiastically for forty minutes with his fellow Commissioners about his visit to Australia and what he had seen and learned here about micro-economic reform and its impact on our competitiveness and public finances.

In just two weeks I will lead the sixth Australian Business Mission to Europe where we will again meet with leaders from the European Commission, the European Parliament, the European Central Bank, BusinessEurope and other important institutions that make up the EU framework. These business missions I believe are playing a very constructive role in breaking down many of the myths and misconceptions in Europe about Australia and in Australia about Europe.

I also applaud the decision of the Australian Government and Austrade to fund and promote the ‘Brand Australia’ campaign in key markets around the world. The campaign is designed to: ‘enhance awareness of contemporary Australian credentials in business, science, education, technology, creativity and not-for-profit activity’, and I am pleased the EABC is one of many partners supporting this campaign.

The work being undertaken by the Australian Government and the European Commission to finalise a treaty-level bilateral agreement, this year, is also a very important step forward in taking the relationship to the next level. But this in itself is not sufficient. Australia needs to work on a completely new strategic framework for its relationship with Europe, incorporating five key elements:

- commissioning a White Paper on Australia’s relationship with Europe
- reviewing and enhancing the way Australian Government resources are deployed in Europe
- developing a programme of official visits to engage Europe’s investment community
- establishing an Australia-Europe Leadership Dialogue, and
- commencing negotiations for a comprehensive Free Trade Agreement

I will comment on each of these five elements.

White Paper

The Australian Government has commissioned Dr Ken Henry to undertake a White Paper on 'Australia in the Asian Century'. This paper has enormous significance not only from an economic perspective but because of its broader geopolitical implications including the impact on our defence architecture and related procurement.

I believe the Australian Government should also commission a White Paper which analyses and makes recommendations on the totality of European 'soft power' and how Australia can better position itself to influence this in support of our regional security and further European investment. The Paper should also analyse Europe's relationships with Australia's major partners including the US, China, India and the Pacific and to identify areas of common interests and actions.

The Paper should make recommendations for devising mechanisms to enhance Australia's influence in Brussels, London, Paris, Berlin, Warsaw and other important European capitals.

Australian Government Resources and Europe

Australia's current representation in Brussels needs to be benchmarked against our Embassies in Washington, London, Beijing and Jakarta. It is disturbing to note that the American Chamber of Commerce in Brussels and our cousins in New Zealand devote far greater resources to Brussels than the Australian Government does.

Our Embassy in Brussels should be the co-ordinating hub for Australian diplomatic efforts across the EU, with the staffing and research capabilities to match.

As previously mentioned, the appointment of the respected national political figure, Dr Brendan Nelson as Ambassador to the European Union and NATO has given enormous impetus to the way Australia is represented in Brussels. Traditionally only Washington and London have been the regular destinations for political appointees with close connections to the government of the day.

It should be remembered that European Commissioners and European Parliamentarians generally have been national political leaders in their own right. The Australian Government should continue to send Ambassadors to Brussels with comparable levels of diplomatic and political standing as they regularly send to Washington, London, Beijing and Jakarta.

Australia's diplomatic efforts should also be reorganised with our Ambassador to the EU and NATO also being designated as Ambassador for Europe.

In addition to their country specific undertakings, Australian Ambassadors accredited to individual Member States could also be charged with responsibilities for Europe-wide policy issues such as energy, innovation, climate change and food security. Australian Embassies in Member States should also work closely with the Brussels mission on relationship-building with the European Commissioner from each country together with influential Members of the European Parliament.

I'm conscious that it is rare to hear a business person advocating more funding for government agencies, but it is clear to me that it is not in Australia's long-term national interests to consistently cut the budgets of those agencies which represent Australian interests globally.

It seems counterproductive to me that at a time when Australia's SME sector is struggling under the combined weight of a high dollar, high real interest rates, high wages and high taxes that the Australian Government consistently reduces its funding to Austrade and DFAT - \$395 million and \$2 billion in the current budget, while spending over \$7 billion on Ausaid. I for one would like to know the actual impact of so-called 'efficiency dividends' on the programs undertaken by Austrade and DFAT and an explanation of why resources devoted to Ausaid have grown rapidly while those devoted to Austrade and DFAT have been repeatedly cut.

Developing new markets and shaping policy outcomes in the US and Europe are resource-intensive investments, and the budgets for Austrade and DFAT in this regard seem woefully inadequate to the growing expectations of them.

Official Visits

At a meeting with the Australian Prime Minister in Brussels in 2010, I made the point that the Australian Government performs poorly compared with many countries in terms of ministers in taking on roles as Ambassadors for the Australian business sector when travelling overseas.

There are many dimensions to the problem including the sensitivity to tax-payer funded travel to Europe, cumbersome approval processes and the expectation that our Embassies will secure official meetings first, and fit in business interests if and when they can.

The economic diplomacy undertaken by Austrade in Europe to encourage investment in Australia needs support from both the government and business sectors, and I am pleased that during our forthcoming visit to Frankfurt and The Hague, EABC members will be making a contribution to this by making presentations on the Australian economy and its investment potential.

But much more needs to be done to institutionalise this effort. The Prime Minister and leading government ministers should undertake regular economic missions, and work better with our Embassies, Austrade and business organisations in targeting those countries, companies and institutions which have major investments in Australia. It would come as a surprise to many in Australia that The Netherlands is the fourth largest investor in the Australian economy, and Belgium the eleventh.

The Chairmen, CEOs and CFOs of Australian public companies with significant offshore investors devote a considerable period of time ‘on the road’ reporting on their performance and future business plans. This should be no different for Australian government leaders particularly in light of the growing capital and funding needs of Australian companies, our banks and the government sector as a whole.

Australia-Europe Leadership Dialogue

Earlier I referred to the importance of the Australian American Leadership Dialogue. Founded in 1992, this dialogue has become a pillar of Australia-US relations and a forum for government, business and policy figures to meet and discuss key aspects of the ‘special relationship’. A key objective of the EABC is to see a similar Dialogue launched, on a biennial basis, between Australia and Europe.

An Australia-Europe Dialogue would serve the purpose of galvanising all the elements I have referred to above, and the inaugural Dialogue should be held either this year or next with the theme being ‘policies for growth’. Europe can offer insights into its progress in achieving a common market of 500 million people which is relevant to the COAG process, while Australia can share insights on its decades of micro-economic and public sector finances reform together with our respective experiences in the US and Asia.

Free Trade Agreement

The EU is ambitiously targeting many of Australia’s trade and investment partners for free trade agreements including India, Japan, Korea, Malaysia and Singapore.

Although it has a preference for entering into FTA discussions with non-OECD countries, since 2009 the EU has been negotiating a closer economic relations and trade agreement with Canada. The reason this came about is that Canada’s Government and business community combined forces to provide a compelling case for doing so.

As leading businessman and EABC Member David Mortimer stated in his Review of Australia’s Export Policies & Programs in 2008: ‘With the conclusion of (the Australia-US FTA) and the

launch of negotiations with Japan and China and the prospect of negotiations with India, Indonesia and the Republic of Korea, the European Union is the only major trading partner with which Australia is not negotiating or considering negotiating an FTA.'

An FTA with Europe should be seen now by the Australian Government as strategically importantly as the Government viewed its FTA with the United States and apply the focus, drive and resources to achieve it.

With stalled negotiations at the Doha level, an FTA between Australia and the EU should be the appropriate vehicle for setting an ambitious agenda for removing obstacles for Australian agricultural exporters, removing unfair taxes on imported automobiles, devising mechanisms for resolving a range of differences on food standards, and other regulatory 'non-tariff' barriers. With Europe now Australia's largest services trade partner, Australia should be seeking a comprehensive FTA including mutual recognition of professional qualifications in the services sector.

Given that this lecture is co-sponsored by the ANU Economics Department it would be remiss of me not to address some of the fundamental economic challenges that Europe needs to confront. This is not just of academic interest but is vitally important to Europe's stability and its future capacity to project soft power in the Asian century.

The debate about the whether the Euro and the Eurozone is fundamentally viable from an economic perspective has exercised the minds of distinguished economists and generated heated debate. As a mere former ANU Iron Man I suspect I'm not alone in trying to make sense of this. The debate has been so polarised and with plausible arguments on both sides it's difficult to judge the outcome.

A key question asked in this debate is whether more could have been done to avert the Eurozone crisis. A Treasury official would probably argue that interest rates in the Eurozone were set largely on inflationary expectations for the economies of Germany and France by the ECB. They were therefore set too low to prevent an asset price bubble in Portugal, Ireland, Greece and Spain.

I am not sure that had interest rates been set on a more restrictive basis this would have changed things fundamentally. My view is that the banking and bond markets took the view that with the advent of the Euro, the economies within it would converge in productivity terms justifying similar asset and labour prices across the Eurozone. This led to a wave of money seeking higher returns in higher risk economies which were somehow expected to transform into German models of productivity.

The markets overlooked for far too long the fact that German asset prices and labour costs remained tightly controlled while productivity increased significantly, contrasting with the rising asset prices and labour costs in peripheral Member States that way outstripped their productivity growth.

Financial largesse applied in the peripheral Member States was aided and abetted by massive regulatory arbitrage courtesy of Bank of International Settlements capital rules for banks and insurance companies. These rules had the effect of encouraging banks to buy 'risk-free' rated sovereign debt of peripheral Eurozone Member States which had no requirement for capital to be put aside for possible default, and this debt could be held on a bank's balance sheets at face value rather than at market value.

So again I wonder given this situation whether higher real interest rates in the Eurozone prior to the GFC would have had really affected the deficit funding of Greece and Portugal and the asset price bubbles in Spain and Ireland. Throughout history we have seen speculative bubbles including tulips, nutmegs, dotcoms and mining which do not necessarily react to interest rates or monetary policy settings but develop a life of their own until they burn out with all the loss, pain and suffering that accompanies this.

So we are at such a time of pain and suffering within the Eurozone or, more correctly, within parts of the Eurozone because if you visit Germany you see a different scene than you do in Athens or Madrid. And indeed things are pretty tough in a non-Eurozone Britain which raises another question - would this speculative bubble have happened anyway, with or without a single currency?

But with a single currency, everyone from Madrid to Manila to Manuka asks themselves what is going to happen next? An enormously complicating factor is the institutional framework around the Euro which was fundamentally conceived as a political project – despite the best efforts to build in some firm ground rules to ensure the integrity of the system.

The complexity of establishing the Euro and the political compromises necessary to achieve it currently leave Europe with some profoundly difficult issues to deal with. Whilst the focus of the crisis is on the common currency, essentially this is a crisis in the finances of EU Member States, and of the public institutions, banks and other investors who have continued to finance unsustainable levels of public debt.

Business people generally have a pragmatism based on hard-headed self-interest and the interesting thing to me is, despite the current crisis, there is still strong public and business support for the Euro. There is great value in eliminating exchange rate risk and the flexibility associated with the movement of capital. In a similar vein there are regions and States in the US

which would theoretically be better off with their own currencies. There are persistent economic and income differences between US regions based on comparative advantages which have been locked in for decades as a result of their single currency.

Prior to the establishment of the Euro, housing prices and labour costs in southern Europe were a fraction of those in northern Europe. Now that the free champagne from the bond markets has been cut off and in the absence of a flexible exchange rate there is going to be a very painful adjustment of income, costs and asset prices in Portugal, Ireland, Greece and Spain as they move to those levels reflecting their comparative economic position in the Eurozone. This may persist for generations, as per the US.

Interestingly enough I am less concerned with Italy which is a highly productive, export-oriented and wealthy economy. Italy has a somewhat undeserved reputational issue largely as a result of political theatre which has been substantially addressed. Its banking and domestic savings are sound in contrast with that of Spain, and its economy is far more sophisticated and diverse.

So the establishment of the Euro has had some pretty interesting outcomes and consequences when you think about Professor Swan's small country theorem. Those countries which have had the most difficult adjustment to the Euro have been small countries with highly inflexible labour markets, large bureaucracies, few natural competitive advantages and a slowness to reshape and adapt their economies in the face of globalisation.

However for those who would argue that Greece would be better off leaving the Euro and returning to the Drachma with its own exchange rate, I would point out that if currency devaluation was an alternative to sound fiscal management, Zimbabwe would be the richest country in the world.

Unlike businesses reporting to their shareholders, regulators, market commentators and financial analysts, most governments in Europe and indeed globally have been unwilling to have a mature discussion with their voters about where their public sector finances stand and the real capacity to pay for past election promises and ongoing healthcare, pension and other benefits.

Australia is very different from Europe and the US as a result of two very major reforms – compulsory superannuation and intergenerational reports which presented a factual analysis of the future demands on government finances in the future. Further, I would argue that Australia's Future Fund was as important for its educative role about public sector finances inasmuch as it was for funding public sector pensions for which it was established.

These and other initiatives have given the Australian public a level of financial literacy not evident in Europe or the US. I can't think of any other country in which the evening news

bulletins include reports on global sharemarkets, exchange rates and the price of major commodities including oil and gold.

Economic circumstances are going to lead to a broader debate about what it means to have a more harmonised internal market and here I'm talking about further pension reform and labour market flexibility in Europe. For example there will be a great deal of resistance by China, India and other high growth economies having IMF facilities allocated to countries without undertaking painful domestic reforms. This cannot be avoided if parts of Europe are to grow at all over the next decade.

Australia with its 25 years of micro-economic reform under both Labor and Liberal governments has a great deal to offer Europe in terms of sound advice in this area. Although in its totality the Eurozone is a huge economic power, in order to flourish it has to adopt the theorem of Professor Swan and think more like a small power/price-taker, for the economic challenges posed by the rise of Asia have only just begun.

So, to conclude, I for one do not see the break-up of the Euro as a likely outcome, but I do see the ECB having to provide more liquidity to the banking system, somewhat less austerity than is currently being advocated by Germany and a lot more micro-economic reform than the peripheral Member State economies would like.

Ladies and gentlemen I hope by now it is abundantly clear that while Europe has enormous issues to deal with, it is economically and strategically aligned with Australia. It has shared values and the same rule of law, democracy and human rights and it is absolutely in our national interest that the EU project is successful because of our need for Europe to continue to project its 'soft power' in the future of the Asian Century.

Australian Government and business leaders have not paid sufficient attention to the influence and importance of European 'soft power' in global affairs. There needs to be a whole of Government rethink about the shape, scope and nature of our engagement with Europe and the European Australian Business Council will continue to play a constructive role in promoting this.

The European Union is one of the most extraordinarily successful political, economic and social projects in the history of mankind. It has united a continent whose past has been marked by an endless sequence of conflict and which brought it to the brink of utter devastation in the twentieth century. As the march of history brings the global focus closer to this part of the world, let's work together with Europe to shape its future based on our common values.

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