



Policy Notes

Issue 6, 2022

Multilateral Context for EU-Australia Economic Cooperation

Author: Paul Gretton

This Policy Note is part of the Jean Monnet Erasmus+ Centre of Excellence on Closer Economic Cooperation between EU and Australia. (EUOzCEC).

Introduction

The positive effects of global trade liberalization and domestic reform have seen the share of trade in global value added increase from around 12 percent in 1960 to above 30 percent pre-GFC (Figure 1). Despite the signing of the WTO Bali Package in 2013, the expansion of the Information Technology Agreement in 2015 and the continued formation of bilateral and regional preferential trading agreements since the GFC, growth in trade has not kept pace with growth in global output.

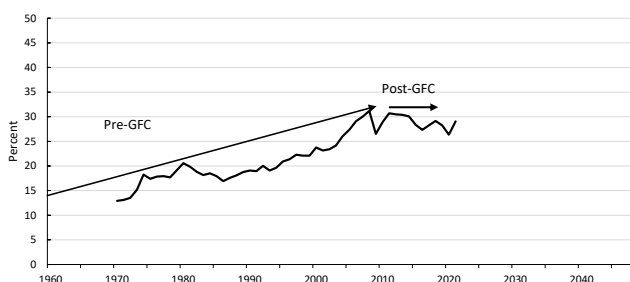


Figure 1: Global Exports to Global Product
Source: World Bank 2020, World Development Indicators. Author estimates.

Trade growth in Europe was accelerated by the formation and expansion of the Common Market and the European Union while trade growth in Australia has been accelerated by domestic economic reform,

the formation of the Asia-Pacific Economic Cooperation pact and rapid growth in neighbouring economies. Both regions have benefited from the global opening of trade and commerce which has seen the global average border protection, measured as the mean ad valorem equivalent of applied tariffs, decline from 15 in 1990 to around 5 percent in 2017.

Following the GFC, growth in global trade has been sluggish with recent trade tensions and the effects of the COVID-19 pandemic providing doubt as to whether these trends will change any time soon.

Within this global setting there has been enduring commercial ties between EU countries and Australia. The most recent data indicates that EU countries investment in Australia in 2021 amounted to about AU\$763 billion or 18 percent of total inward foreign investment (ABS 2022), while Australian investment in the EU amounted to AU\$369 billion in 2021 or about 11 percent of Australian investment abroad (ABS 2022). Of this investment, EU FDI in Australia amounted to about AU\$120 billion while Australia's FDI in the EU was about AU\$57 billion. Imports to EU countries from Australia totalled AU\$12 billion in 2019-20 while exports from EU countries to Australia totalled \$AU47 billion in the same year (DFAT 2022). Exports from EU countries to Australia have been weighted

towards manufactured products particularly machinery and equipment, while exports to EU countries from Australia have been weighted towards agricultural and mineral products..

The future of the EU-Australia trade relationship will be shaped by domestic economic developments in each region together with broader developments in the global economy. This policy note explores the implications of capital deepening in emerging markets, resource and energy constraints, and the changing centre of gravity of global trade as it may affect EU-Australia economic cooperation. It concludes by considering what these developments may mean for the progress of globalization and the evolution of the EU-Australia economic relationship.

Capital deepening in the developing world will compete for funding and resources

Despite a near 100 fold increase in fixed capital in China and substantial increases in capital in other non-OECD economies particularly in the Asia-Pacific region over the 55-year period 1960 to 2015, there is a substantial, but variable, gap between fixed capital per person in non-OECD economies and OECD economies, including the Europe-28 group and Australia (Figure 2).

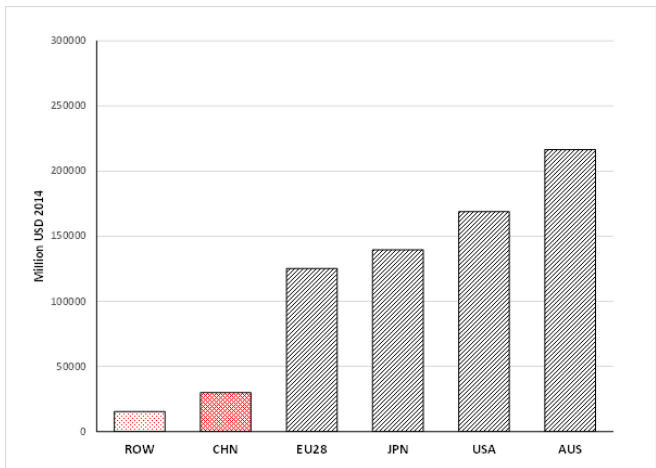


Figure 2: Comparison of fixed capital per person, 2014 (million USD)
Source: Aguiar, A. et al. (2019).

Progressive closing of the gap will have to compete for domestic and foreign savings to fund new capital formation. Closing the gap will also generate competition for the resource and produced inputs (including energy, metals and minerals) required to produce investment goods and services. The pressures will extend beyond the building-catch up

phase to the operational phase when installed capacity is deployed to provide new goods and services to consumers and maintain and expand installed capacity. A sense of the scale of future activity on the capital account can be given by a comparison of the hypothetical capital stock and annual investment, if capital per person in non-OECD and OECD areas were to be aligned. In this hypothetical case, the level of capital in the non-OECD area could be about seven times the current level. In global terms, installed capital would be over four times the current level.

Such a parity will take many years to reach and some countries will get to their own parity conditioned by local circumstances, quicker than others. Nevertheless, the convergence and maintenance process will put competitive pressure on domestic institutions to maintain an attractive local investment environment and international institutions to facilitate the orderly movement of capital between regions. At the firm level, business people will confront decisions as to whether to invest locally or abroad, including in the EU and Australia as they move up the productivity and scale ladder. With the inevitable increase in scale in two-way direct, portfolio and other investment between regions, payments balances and the monetary system are likely to achieve even greater focus as are international standards for intellectual property and guidelines for cross-border taxation and business conduct.

Energy supply and use

Economic development is dependent on the use of energy to power industrial and commercial processes, transport and communication, and consumption.

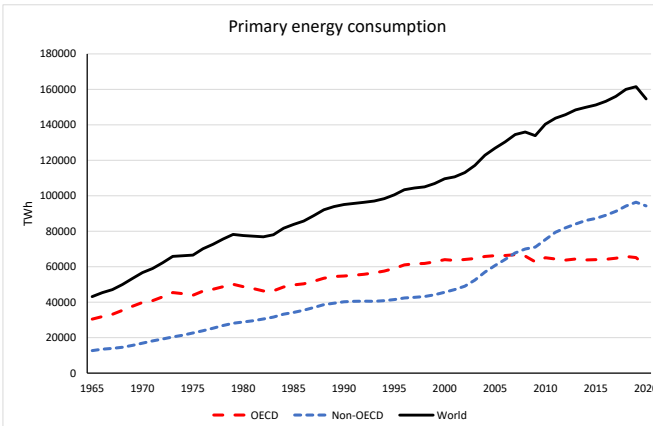


Figure 3: Primary energy consumption for OECD and non-OECD regions, 1965 to 2019, TWh
Source: Author aggregations based on “energy” data in Ritchie, Roser and Rosado (2020).

Globally, there was a three and half fold increase in recorded energy consumption world-wide from 1965 to 2019 (Figure 3). Consumption by OECD economies increased two fold while consumption by non-OECD economies increased over seven fold, albeit from a low base. By 2019, the non-OECD group accounted for 60 percent of global consumption up from the 1965 share of 30 percent.

Growth in energy consumption was most rapid in emerging and transition economies. For example, recorded energy consumption in China increased six fold over the data period while consumption by ASEAN economies collectively increased around seven fold. On the other hand, recorded energy consumption in Sub-Saharan African economies expanded only two fold. In per capita terms, non-OECD economies used about one-third of the energy supplied. The actual energy consumption though is somewhat higher because of unrecorded energy sourced to household use of fire wood, animal dung or other fuels by households.

The largest proportion of energy used globally is accounted for by naturally occurring minerals: oil (33 percent in 2019) followed by coal (27 percent) and natural gas (24 percent) (Figure 4). A further 4 percent was accounted for by nuclear fission. The mineral-based energy sources are complemented by energy harvested from natural systems, particularly hydro-power (6.5 percent in 2019) and less so solar, wind and other power sources (2.2, 1.1 and 0.4 percent, respectively, in 2019).

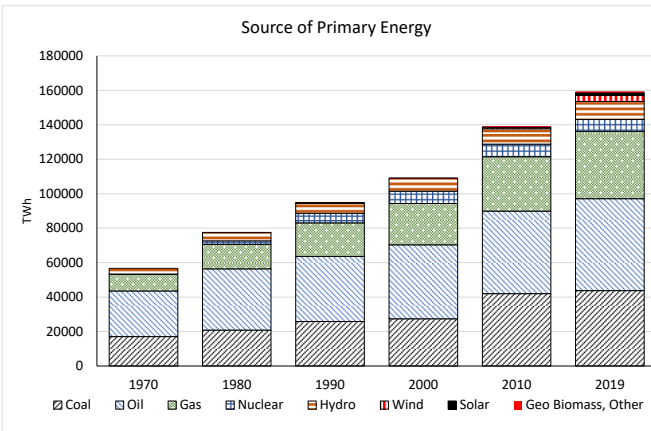


Figure 4: Source of primary energy, 1970 to 2019, TWh
Sources: Author aggregations based on “primary-energy-source-bar” data in Ritchie, Roser and Rosado (2020).

If non-OECD economies, through their own economic development, ultimately reached a level of per capita energy consumption and living standards on a par with the OECD group, non-OECD energy consumption would be about three times current levels (figure 5). In global terms, energy consumption could be two times

above current levels. Admittedly, such a convergence would take many years if not millennia to occur. Nevertheless, even a gradual closing of the gap (from low to middle income and from middle income to high income) would place additional pressure on fossil fuel reserves, land on which to locate energy harvesting activities and the energy and materials needed to build the supporting facilities and infrastructure. It would also test the boundaries of technological innovation and ways of working to economize on the use of natural and environmental resources, and keep pace with economic development. The emergence of China as a major energy user in the global economy illustrates the scope for the balance and scale of energy use to increase rapidly as an economy converges towards the global production frontier with domestic policy changes and accommodating changes in international trade diplomacy.

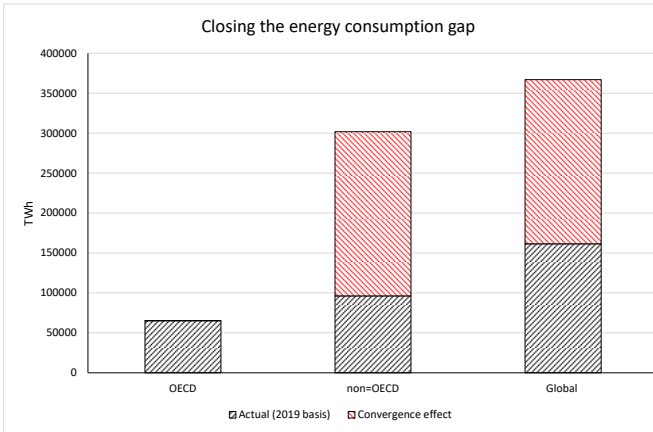


Figure 5 Closing the primary energy consumption gap, 2019 basis, TWhs
Sources: Author estimates based on “energy” data in Ritchie, Roser and Rosado (2020); World Bank (2022c).

To maintain and improve the living standards across all countries, there is a clear need for the introduction of new general purpose technologies for the supply and use of energy while meeting stringent demands for lowering carbon emissions. The EU and Australia, being regions at the frontiers of energy supply and use, jointly have an important role in this broad process. There will be opportunities to deepen research partnerships in frontier research, lower barriers to the transition from the research and development phases to the implementation phase. As with ICTs and other new general purpose technologies, the greatest social benefit will come from use. Impediments to efficient research and restrictions on the mobilization of new general purpose technologies through protectionist Intellectual Property laws would slow the progress of technological change and the introduction of new ways of working. Measures to protect local firms in the supply and use of new general purpose

technologies through exclusivity agreements are also likely to be harmful.

The balance of economic gravity and trade is changing

There is considerable uncertainty surrounding how global trade may evolve. This uncertainty is heightened by the COVID-19 global pandemic and interruption of supply chains, and global trade tensions and higher trade costs through tariff and non-tariff barriers. Trade tensions and increases in trade costs could be associated with continuation or erosion of the current proportion of trade as a share of global product of around 30 percent. On the other hand, strong assumptions about import tolerance and the lowering of trade costs could see the momentum of trade growth return to pre-GFC rates with trade approaching 40 percent or higher of global output by 2050 (figure 6). Recognising the considerable uncertainty surrounding import tolerance and the progress of globalization, a middle-ground perspective whereby trade may reach around 35 percent of global output by 2050 provides a meaningful context in which to consider the future evolution of the EU-Australia trade relationship (see box for trade growth assumptions).

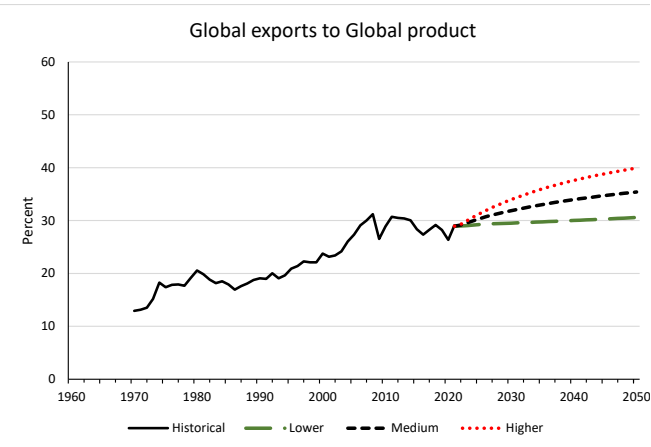


Figure 6: Historical estimates and baseline projections of global exports to global product, 1960 to 2050, percent
Source: World Bank, World Development Indicators (accessed October 2020); Author GDyn-FS projections.

Importantly, this relationship is likely to evolve in an environment in which the trade footprint of the potentially faster growing non-OECD area is expanding, possibly substantially (Figure 7). In all likelihood this will be combined with an increase in trade connectedness between economies within the non-OECD area. And while the footprint of China

expanded rapidly following accession to the WTO, domestic policies focused on greater self-sufficiency and a further emergence of consumption demand by households, either directly through private final consumption or indirectly through government service provision could see a gradual lowering of China’s share of global imports. Simultaneously, the footprint of the slower growing OECD group would decline, and for the Europe 28 area, substantially so. In this environment, it is most likely that both the EU and Australia will find a larger share of their exports absorbed by the non-OECD area. Large disruptions to the existing order could occur.

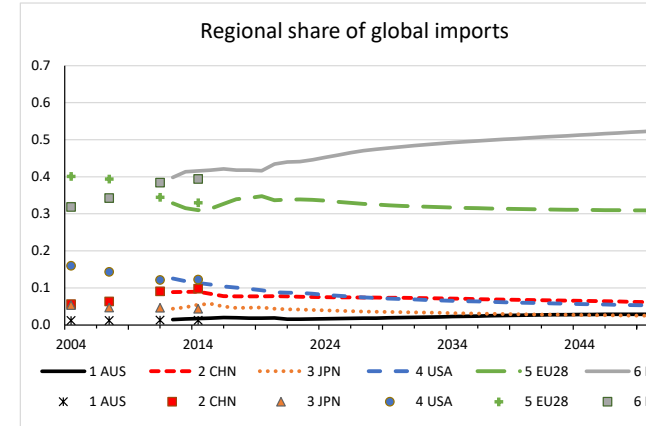


Figure 7: Historical estimates and baseline projections (medium trade-potential scenario) of regional shares of global imports, 2004 to 2050, proportions
Source: Author estimates based on GTAP 10 data; Author GDyn-FS projections.

Some implications for the evolution of EU-Australia economic cooperation

Preparedness for future shifts in economic gravity places a policy premium on domestically-led behind the border reform favouring policies that: (i) increase competitiveness of domestic firms in existing and new global markets; (ii) lower the cost of trade in a non-discriminatory manner across markets (including through lowering remaining MFN tariffs and NTBs); and (iii) avoid undue impediments to trade (such as bilateral and regional trade conflicts, preferential rules of origin on goods and services). It also places a premium on non-discriminatory multi-lateral, plurilateral and open regional institutions that promote cooperation and a non-discriminatory order at the global level versus institutions that focus on preferential bilateral and regional arrangements that may divert resources from their most productive use and contribute sticking points for wider cooperation.

Preparedness for future trade and capital deepening across the globe will also place a premium on monetary and payments systems that effectively support international trade and commerce across a broadening base. Efficient development and exchange of new technologies will be important to satisfying future needs for energy and economic development.

These multilateral influences will be important in setting the context of EU-Australia economic cooperation into the foreseeable future, as well as development opportunities in the respective regions.

Box: An illustrative scenario for regional trade shares into the future

How the EU-Australia economic relationship evolves will be influenced by existing trading ties and also how those ties may evolve into the future.

A perspective on this can be given by forward projections that allow for: (i) the value of trade as a share of GDP for Australia, Japan, the USA, and the Europe 28 area to be uplifted by 10 percent from 2019 levels; (ii) a convergence of trade shares for China to the levels in the neighbourhood of forward views for Japan and the USA; (iii) the value of trade as a share of GDP for other regions (combined) to converge towards the share for the multi-country Europe 28 area; and (iv) the balance of trade as a share of GDP to approach rates based on historical experience across regions. Gross saving as a share of GDP for China is also projected to converge from historically high levels of around 45 percent to a level in the neighbourhood of other regions of 27 percent. Collectively, this perspective projects an increase in the global share of trade to GDP from 30 percent from a 2019 (pre-Covid) benchmark to 35 percent. Stronger assumptions about trade growth in the OECD area and convergence of the extent of trade relative to output in the non-OECD area would yield higher projected increases in trade and a share of global output.

Source: Gretton (2021).

CONTACT US

**The Australian National University
Centre for European Studies
(ANUCES)**

**Research School of Social
Sciences,**
RSSS Building, Level 2,
146 Ellery Crescent,
Canberra ACT 2601,
Australia

Anne McNaughton, ANUCES
Director

T: +61 2 6125 6778

E: europe@anu.edu.au

W: <http://ces.anu.edu.au>

CRICOS Provider #00120C

References

- ABS (Australian Bureau of Statistics) 2022, '*International Investment Position, Australia: Supplementary Statistics*, 2021, Cat. No. 5352.0, Tables 2 and 5, (accessed 14 June 2022).
- Aguiar, A. et al. 2019, 'The GTAP Data Base: Version 10', *Journal of Global Economic Analysis*, Volume 4 (2019), No. 1, pp. 1-27, at <https://www.jgea.org/resources/jgea/ojs/index.php/jgea/article/view/77/96> (Data Base identifier: v10_2014_Sept 2019).
- DFAT (Department of Foreign Affairs and Trade) 2022, 'European Union', Facts Sheet (accessed 5 June 2022).
- Gretton, P. 2021, 'Historical validation of saving and trade intensities using the GDyn-FS model and historically informed baseline projections', Presented at the 24nd Annual Conference on Global Economic Analysis, Virtual Conference at: https://www.gtap.agecon.purdue.edu/resources/res_display.asp?RecordID=6299
- Ritchie, H., Roser, M. and Rosado, P. 2020, *Our World in Data: Energy*, Published online at OurWorldInData.org. at: <https://ourworldindata.org/energy> [Online Resource] (accessed 31 March 2022).
- World Bank 2022, *World Development Indicators*, at <https://databank.worldbank.org/source/world-development-indicators> (accessed 28 April 2022).