THE NEW GLOBAL MOSAIC
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Paul Keating's 'The New Global Mosaic' was an up-to-the-moment yet sweeping analysis of the global scene. At the time of the speech, the US economy had been in recession for three years. In it he predicts the US will come out of recession 'from about now'—and further predicts that the new investment cycle might have 'half a dozen productive years' in it, ending in 2009 after a stockmarket peak in 2008. The speech is prophetic in a number of other respects. Paul Keating says East Asia was likely to mark itself out as a growth engine of the world; China has the promise, geostrategically, of becoming the 'second pole'; he questions whether Europe's one-size-fits-all fiscal and monetary union will work smoothly and says that US unipolarity is unsustainable, that its wars against errant states will lead to American exhaustion. He concludes with the view that the United States has to return to a policy of liberal internationalism.

In the business of nation-building —which is the business of all of us in public life—we are creatures of our time and circumstances. Of the prevailing geopolitical and geoeconomic moods. And we are always searching for the Rosetta stone, that code stone that tells us how best to find that happy mix between what should be rendered unto Caesar—and what may properly be left to the individual.

New Zealand and Australia have much in common, including a very serious effort on the part of each of us in remodelling our economies. With a notion that markets, more efficiently organised, could deliver better outcomes, we each attempted to change our old, protected and closeted industrial societies into more outward-looking, competitive and innovative ones.

The interesting thing about both our countries is that these efforts were, in the main, undertaken by Labor governments. It was once par for the course that Labor governments tended to centralisation and protection, eschewing openness and competition of a kind that, in the event, we both chose. If I could say where I think this process has been different between Australia and New Zealand—in Australia, these things were done in the context of a formal set of long-run consensual policies set out between the trade unions and the government of the day.

While the great wish and want of society will be for economic growth and the pursuit of income, people always yearn for something else as well; and that is to belong, to be included. A sense of nation and well-placed patriotism, based on the family of the country. A sense that change is directed to a point, which extends beyond economic growth to individual and community happiness and fulfilment. It is why those of us in the nation-building business always keep an eye out for the country in the broad, and for those at risk of missing out. It is why the bindings that come with good social policy end up being good economic policy.

The question is, where do we go from here? Much has been achieved, but what do we do now? How do we do things better? How do we move on a wider front, yet move together, and how do we make the interests of any one of us work for all of us?

I have never been in local government in an elective sense, but I have always had a great regard for it, for the authenticity that comes from proximity to the people and their very real problems. Local government in most countries is at the coalface of government and any system which improves the representativeness and effectiveness of government will make society that much better and stronger. So I am pleased to be with this distinguished group of local government representatives gathered to think about their country, to share ideas and consider the future.

I suppose the first trick for you, indeed for all of us, as we survey the world, is to find our coordinates—the degree of strategic longitude and the degree of commercial latitude which reveal exactly where we are. Perhaps, in this discussion, I should deal with the economic latitude first. I will return to the strategic dimension in a few moments.

It is worth noting that there were three economic long waves in the twentieth century—1904 to 1929, 1947 to 1974, and 1982 until now. Each had a duration of about 25 years, and each was technology driven.

The first wave, from 1904 to 1929, was driven by breakthroughs in petrochemicals, industrial production and transportation.

The second wave, the postwar wave, was driven by the economic rebuilding of Japan and Europe, along with technological breakthroughs in areas like plastics and aviation, and, of course, motor vehicles.

The wave we are currently living through, the third wave, has been driven by telecommunications and microprocessing. By all reckoning, if the past is to be any guide, this wave should run until about 2007 or 2008. We have already had two legs, two business cycles, 1982 to 1990 and 1992 to 2000. The second one saw an enormous increase in stockmarket values around the world and in personal incomes and real wealth.

The good news is, I believe that there will be a third business cycle. From about now. The bad news is that it will not be so richly laden as the second one and we are beginning it at relatively high valuations for equities compared with those which obtained in 1982 or 1992. Or those which obtained at about this same point in the second long wave, which would have been about 1965. What will be different about this leg compared to the last two is that towards its end, the technological edge may have dissipated and the demographics will have acted to reduce unemployment substantially. Towards the end of this cycle, in say five to six years from now, we may see a pick up in real wages and with it wage inflation of a kind which may encourage central banks to do what they have traditionally done, and that is, cool the economy to keep wages and prices under control.

Where the last wave ended with an exogenous shock, from the inflationary OPEC pricing of the early 1970s, and the one before that with the Depression in 1929, this one may actually go down for endogenous reasons as we struggle to maintain workforce growth in countries like our own. At any rate, we've probably got half a dozen years left in this cycle before more negative economic forces materialise.

One of the caveats, which could affect this scenario, is the potential for East Asia to mark itself out as the growth engine of the world. China, with its World Trade Organization (WTO) mandates, holds out the promise of being the most important growth economy in the world outside the United States. And China is no typical East Asian top-down command economy of the kind we see in Japan or South Korea, where financial intermediation is managed largely by banks in the absence of efficient capital markets. China will, over time, have a range of financial markets and instruments. As it grows, it will reveal itself to be an economy built around the individual and small-to-medium enterprises—an economy far more reminiscent of New Zealand's and Australia's than Japan's. It will become, I believe, a place with which New Zealand and Australia, in a corporate sense, will want to do business. It is also likely to become, in geostrategic terms, the second pole in what has become a unipolar world. China has the certainty of knowing who and what it is, and the cultural confidence to cope and deal with the United States.

Japan, a great trading partner of both our countries, has been in a structural recession for fourteen years and there is a distinct possibility that its financial system will be subject to seismic fractures of a kind that could bring its economy to its knees. There is also an acceleration in the deterioration of its demographics.

Whether North Asia and its poorer cousins in Southeast Asia can make a difference as to how the world behaves economically five years from now remains open to conjecture. But it is the part of the world in which we live, and its future matters mightily to us, because more of our bread is going to be buttered by what happens there than in any other place.

Some believe that Europe's aggregation of populations and economies would make it a logical alternative pole to the United States. But it is yet to be seen whether the one-size-fits-all fiscal and monetary policies agreed under the Treaty on European Union will be capable of working smoothly. The arrangements are providing financial management at the broad fiscal and monetary level, but at an obvious cost. We can already see how they are limiting Germany's capacity to restimulate its economy through fiscal policy or to run a monetary policy more appropriate to German conditions.

Perhaps more importantly, Europe remains diverse and politically fractured. It simply does not possess the coherent cultural confidence of, say, the United States or China. It may have a common market and a common currency, but it is burdened by centuries of ethnic and national suspicions. It also lacks the force projection and the arsenal of conventional and nuclear weapons enjoyed by the United States.

Let me now say a few things about the American economy. The first thing is its absolute size. At US$10 trillion, its GDP is twenty times larger than Australia's and about 150 times larger than New Zealand's.

The United States has pulled the world economy along for over a decade. The American consumer, in effect, saved the rest of us. Its great strength is that it has a fungible capital market which can take capital from less productive places and put it into more productive places in its economy, faster than in any economy in the world. The administration of President Clinton also took the United States from historically large central government deficits to large central government surpluses. By reducing the relative size of the public sector in America, ipso facto, the private sector became that much bigger.

But another very important thing happened. The governor of its central bank, Alan Greenspan, uncharacteristically for central bank governors, pursued a policy of growth to maximise wealth and incomes. Most central bankers of his standing and responsibilities would normally keep a baton of price stability in the knapsack and not much else.

Greenspan thought he could and, in the end, did see a paradigm shift in productivity of a scale which he knew could deliver rising real incomes in the context of falling unit labour costs. So he kept monetary conditions accommodating to growth through the 1990s, believing that the productivity wedge would pay for the wages growth which in other times would have come at the expense of profits. He had the golden circle working for him—rising real wages, rising profits, falling unit labour costs and falling inflation. The consequence of this extended period of his management was to increase the capacity of the American economy to grow at a rate faster by half than we had formerly witnessed.

Notwithstanding this achievement, Alan Greenspan is not without his critics. Some say he should have dealt with the asset price bubble of the Dow and NASDAQ even after his warning in 1996 about 'irrational exuberance'.

But this opens an old argument. Should central banks focus solely on activity in the real economy and inflation or should they also attempt to operate policy to deal with asset prices? Personally, I have always seen activity, inflation and the real economy as being the monetary touchstones. In the end, high stock prices imply low dividend yields and these, over time, correct themselves. Investors can turn to bonds. And in the United States, you can purchase Treasury bonds which are indexed for inflation—where the real interest rate is constant and known at the time of purchase. Markets do work as prices adjust to yields.

Greenspan, I believe, saw the main chance to move his economy up a notch to a sustainable new plateau of activity, having its inflation rate protected by productivity.

In the past quarter century, the speed limit for American GDP growth was of the order of 2.0 to 2.5 per cent or thereabouts. That limit now has a substantial 3 in front of it. And to have a base of $10,000 billion growing at an extra 1 per cent in the context of continuing low inflation is a mighty achievement. And a lot of new wealth.

These are some of the reasons why America has been the motor economy and why we owe Clinton and Greenspan, in these respects, so much. I might say, but only in passing, that following the microeconomic reforms in Australia over the same period, the Australian economy grew by an even greater degree—from an average of 1.7 per cent in the decade to the mid-1980s to an average now of over 3.5 per cent—with endemically low inflation made possible by a doubling of trend productivity. Put in place by a Labor government. That productivity wedge is, in the end, what the game is all about. It is not just the icing on the cake—it is the cake. It is the reason why real incomes in Australia grew by 20 per cent across the 1990s—the fastest real income growth in any decade of Australia's history. It did for Australian competitiveness the very same thing that Mr Greenspan and his productivity dividend did for the United States and its consumers.

But America has been in a growth recession for the last couple of years. It has not experienced negative growth, but its growth has been much slower—something like 1.5 per cent—because its investment cycle topped out in 1997. Business cycles are, of their essence, investment cycles, and there has been an investment drought in America now for just on six years. That's why we owe the American consumer so much for taking up the slack. But even the American consumer couldn't keep it up forever.

So now we await the upturn in the American investment cycle. The question is, when will that occur? My best guess is, any time now. Stockmarkets invariably pick the turn well before the real economy, and faster than the rest of us, and such a turn normally leads the investment cycle by nine to twelve months. When we look back I think that we will find that the stockmarket turn, this time, came between November last year and March, heralding a turn in the business cycle for later this year.

Now, there have been, as the Americans call it, headwinds. These are not necessarily economic forces but they do matter—things such as the corporate scandals (the Enrons, the WorldComs), the war in Iraq and other negatives. But the fundamentals out themselves in the end. The cycle turns.

So let me recap: I think there is going to be a third leg, a third business cycle. The downside is that it will not be as rich as the last one. But a third leg anyway.

The real imponderable is the geostrategic setting. We should know, if we have forgotten, that the strategic climate governs everything. We should never forget that globalisation started in earnest in the last quarter of the nineteenth century when the biggest sinew of trade was between Great Britain and Germany. This did not stop either country drifting into the First World War, the repercussions of which only saw the world economy get back to sustainable growth as late as 1947 and to strategic equilibrium in 1989.

We are, they tell us, living in a unipolar moment, when the US has decided to eschew liberal internationalism and multilateralism for a winner-take-all, me-first strategy. The whole political and strategic framework of containment has been tipped over for an aggressive pre-emptive first-strike doctrine which gives the rest of us very little to be part of, or little to attach ourselves to.

I think what happened is that when the Cold War finished and the Berlin Wall came down, the Americans cried victory and walked off the field. You might remember the slogan that Clinton used against George Herbert Bush, 'It's the economy, stupid'. Clinton was scathing at Bush's adventurism, as he saw it, in Iraq in 1991. And before the investment cycle kicked back for the second leg in 1992, George Herbert Bush was defeated and American public policy focused on a peace dividend. It also focused on its economy and the magic of the Internet. It seemed as though the Cold War had not ended for the Americans, but simply faded away.

Of course, it did end for the Americans. It ended when the Twin Towers came down in September 2001. It ended with a bang. Clinton and Gore would have handled this strategic moment very differently from Bush, Cheney, Rumsfeld and Wolfowitz. The current administration has responded by jerking American policy into a unilateral response, rejecting in its application any notion of cooperation or resort to multilateral frameworks.

The real question is whether this policy is rewarding or sustainable or whether it will leave America exhausted by the self-wrought responsibility of dealing with errant states and groups which it deems to be a threat to its security. This policy comes, I believe, at a very high price. It has fractured the 50-year-long spell of Atlantic unity and tugs away at the notion of America's 'righteous might', a notion to which President Franklin Roosevelt so often referred.

Churchill said in 1940 that Britain was 'fighting by ourselves alone, but not for ourselves alone'. A lot of people, I am sure, think today that the United States is fighting by itself alone, for itself alone. This is not good. The big question is: can the world be run from one city? Does the American Congress have the wit and the wisdom—let alone the resources—to run the globe?

I, for one, do not believe it does. For all of its glory, indeed its past magnanimity, any attempt by America to take on the mantle of Empire is to deny the very precepts of its founding.

The really bad news in all of this is that by walking away from multilateral arrangements such as the Comprehensive Test Ban Treaty and the Anti-Ballistic Missile Treaty, and by their failure to live up to commitments made under the Non-Proliferation Treaty, the Americans have given a signal to the rest of the world that they too can be part of a resumed nuclear arms race. Believe you me, this has well and truly begun. Not just in India or Pakistan, or Iran and North Korea or even Israel, but in lesser states which believe they need their pocket nuke to make the world deal with them respectfully. I hope the Americans have not led us into a Mad Max world while they seek to shield themselves in the cocoon of national missile defence.

All of this has let a lot of hares run—and as relatively small states with a broadly European complexion tucked away in the bottom of Asia, none of it is much good to us.

Nationalism is generally built on arbitrary and parochial distinctions between the civic and the human community; why we are worthy, and someone else is not. The interests of the human community, I believe, deign that the world must be run cooperatively. This period of strident American unilateralism and militarism cuts across this notion while putting no adequate or alternative framework into place.

Let me conclude then, by returning to the positive things. There are, I believe, half a dozen quite productive years left in the international economy and it might be longer if the North Asians can keep their act together. But unless the current American administration returns to a more liberal notion of internationalism we will overlay these positive economic prospects with geostrategic uncertainty of a kind that is debilitating and broadly unnecessary.

All of this may seem a long way from the considerations of local government. But, as I said, you need to take your coordinates before you start any journey. I wish you all the best for your deliberations over the next few days.