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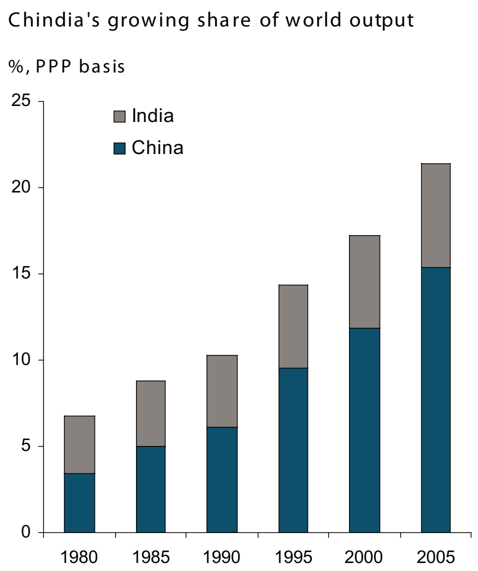
Forged by the fall of the Berlin Wall, the liberalisation of markets for goods, services and capital, and the economic transformations of China and India, the new global economy has been a particularly agreeable environment for Australia. The emergence of new, competitive suppliers of the goods, services and assets we buy has been accompanied by the arrival of fresh, dynamic sources of demand for those we sell. The unprecedented durability of the present expansion, now almost 17 years old, is testament to the overwhelmingly positive consequences of the current international economic conjuncture. The pairing of the 'Australian model' and the global economy at the start of the 21st century seems in many ways to be a match made in heaven, disturbed only by the recent rumbles arising from newly nervous financial markets as they discover, yet again, that for all its other benefits, globalisation has not abolished risk.

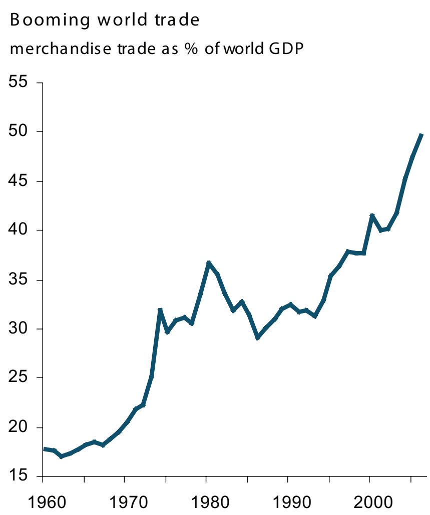


Source: IMF World Economic Outlook database

So is there anything for practitioners of international economic policy to do other than sit back and enjoy the good times while keeping a watchful eye on the antics of the financiers lest they spoil the party? In fact, there are more than enough issues even beyond the turbulent credit markets to keep them occupied.

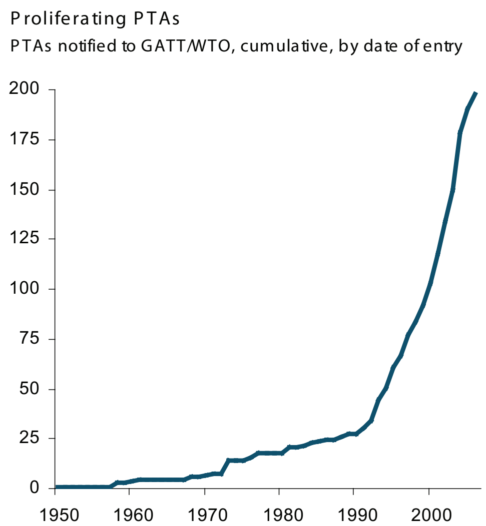
We are in the early years of a period of profound transition for the international economic order, as the consequences of the ongoing redistribution of economic weight across the world economy, driven by the globalisation-powered rise of China and India, are starting to make themselves felt. Managing the resultant stresses and strains will be essential if the good times are to be sustained. Moreover, not everyone attending the global party is having a great time, while others are still waiting for their invitations to arrive. Reconciling the former and including the latter also need to be on the international policy agenda.

The challenge of managing the strains of success is apparent in the case of international trade, one of the two main pillars supporting the new global economy. Recent years have brought a steady rise in the share of international trade in world output.



Source: World Trade Organisation and author's calculation

Yet paradoxically, deepening trade integration has occurred at a time when the multilateral trading system, the ultimate guarantor of the process, has been under mounting pressure. In particular, the Doha round of trade negotiations has lurched from one crisis or stalemate to the next, with the prospect of progress fading all the time. Optimists argue that a final collapse of the negotiations would be no big deal. The magnitude of gains on offer is likely to be small, and anyway, trade has quite obviously continued to expand throughout the repeated failure of the trade talks to gain traction. But there is a powerful asymmetry at work here, as while the upside of a successful Doha round is indeed likely to be modest, the downside of failure could turn out to be substantial, at least in the medium run. The first irrevocable breakdown in ongoing multilateral negotiations since the creation of the GATT in 1948 would threaten the credibility of the current international trading system, risking the gradual erosion of that system's checks and balances. Finding a way to rejuvenate the multilateral system should be a priority for the world economy, and the next Australian government will have to think hard about how it helps the world pick up the pieces after Doha.

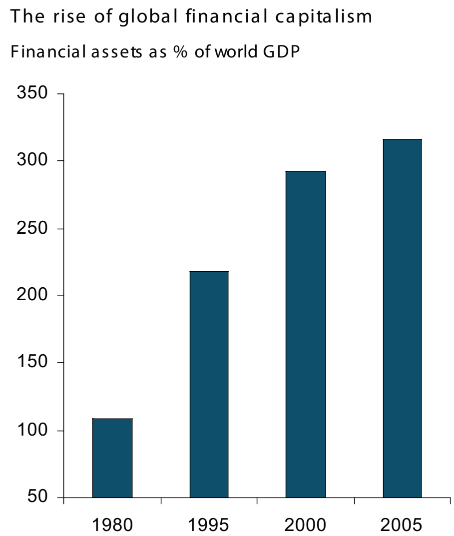


Source: World Trade Organisation

Meanwhile, the pursuit of preferential trade agreements (PTAs) has been virtually every economy's Plan B in response to Doha disappointment, and as a result the number of such agreements has exploded. Australia has joined the rush and is currently negotiating a swathe of new arrangements. Here the next government will face a decision over Australia's declared preference for so-called comprehensive, 'WTO-plus' agreements, and a preference on the part of some key negotiating partners to see the deals in a more symbolic light. Choosing either to compromise on the former to secure a deal, or risk the diplomatic fallout from rejecting the latter is likely to be a test for the ASEAN, China and possibly Japan PTA negotiations.

Negotiating capacity must become a constraint to the present strategy at some point, if it hasn't already, and trying to make sense of the resulting spaghetti bowl (or noodle bowl in the case of East Asia) of overlapping yet inconsistent arrangements of widely varying quality and coverage is now another pressing item on the international policy agenda. The policy issues could become even more pointed in the event of the emergence of competition between rival trade blocs. Consider, for example, if Canberra had to choose between membership in an expanded NAFTA or an East Asian trade arrangement against a backdrop of worsening trans-Pacific trade tensions.

If trade integration has been one pillar of the global economy, financial market integration has been the other. Indeed, the recent history of globalisation has arguably been driven more by finance than by trade. Once again, the international economic architecture has struggled to keep up with market-led integration, and bodies like the IMF are now in the early stages of trying to re-invent themselves.



Source: McKinsey Global Institute

The current bout of financial market jitters serves as a reminder that this new era has been accompanied by a series of financial 'accidents', including the 1994 Tequila crisis, the 1997 Asian Financial crisis, the 1998 LTCM panic, and the 2001 equity market meltdown. Yet calls to rethink the international financial architecture, heard most strongly after the Asian crisis, have so far come to nothing.

Australia has already staked out a pro-reform position in the form of support for redistributing voting power in the IMF and promoting the role of the G-20. The next government will have to consider how to continue and develop these themes, as well as think about Australia's role in an emerging regional financial architecture.

Intriguingly, one source of demands for new international financial regulation has been the recent attention paid to so-called Sovereign Wealth Funds or SWFs as vehicles for increased investment by emerging markets into the developed world. Washington has asked the IMF and World Bank to establish a code of good practice for SWFs, and Brussels is reportedly considering Europe-wide guidelines. Australia already has the Foreign Investment Review Board (FIRB) and Foreign Acquisitions and Takeovers Act. If projections about the wall of money pushing into rich-country assets from emerging markets prove accurate, then this machinery may get a serious workout in coming years. In particular, a future Australian government is likely to have to decide how to deal with SWF-/China-based bids for major Australian companies.

To some extent, the labour market is the missing third pillar of the global economy. In contrast to the efforts made at liberalising international flows in goods, services and financial assets, barriers to labour mobility have remained substantial, with immigration in particular remaining tightly controlled. Given the persistent international disparity between incomes, the compressing effect of the demographic transition on many rich world labour forces, and the spillover effects from liberalisation in other markets, the pressure for greater labour market integration will grow, despite the obvious political obstacles. In this light, a key policy issue is set to be the role of visas for temporary workers in dealing both with domestic skill shortages and in providing support for neighbouring economies.

In fact, national labour markets are already increasingly integrated, thanks to greater trade and financial openness, the rising 'tradability' of many previously sheltered service sector jobs, and the growth of offshoring. The IMF, for example, has recently estimated that the growth in economic openness and the rise in working-age populations in emerging markets, particularly in East Asia, mean that the effective global labour supply quadrupled between 1980 and 2005, with most of the increase coming after 1990. While this development has been positive for the world economy overall, its implications for income distribution and job security in the developed world have contributed to some of the current rich-country backlash against globalisation.

Quadrupling the effective global labour force
Labour force index, 1980=100

Source: IMF World Economic Outlook

Managing this backlash is another important item on the international economic policy agenda. After more than two decades of the pursuit of pro-globalisation policies, significant parts of the developed world are now having second thoughts about the benefits of globalisation. One result has been that the political gains to be derived from promoting more liberalisation appear to be shrinking relative to the payoffs derived from advocating policies designed to temper or modify the forces driving international economic integration. There have also been growing demands for the imposition or intensification of labour, environmental and product safety standards as applied to international transactions. Such calls are set to get louder, and will provide another important element in the international economic environment facing Canberra.