

Will China and India conquer the world?

**Essay: We should celebrate the spread of wealth and modernity in the developing world, while recognising that a great shift in global power is not imminent.**

Stuart Simpson

**The continued rise of the emerging economies, particularly India and China, is never far from the headlines. What impact these economies will have on the twenty-first century is the subject of much debate, with the possibility of a shift in global political power a recurring theme. It is often assumed that the emerging economies are following the same path to development that the established economic powers did - but this assumption is worth questioning.**

The coming shift in the balance of the global economy towards the East is not the result of a slowdown in the developed world; rather, growth in the developing world has, in part, been achieved through exports to the developed world. In return, the emerging economies have supported economic stability in the developed world and promoted growth in commodity-exporting regions such as Sub-Saharan Africa. This process has given rise to what are commonly understood as global imbalances: Western imports rise and cash flows to the developing economies in Asia and elsewhere - cash that is then used to purchase Western debt. That the initial process of unwinding these imbalances has so far been *relatively* painless, particularly in the developing world, is an indication of just how much the global economy has been altered by the rise of the emerging economies.

Nonetheless, while the emerging economies are growing rapidly, they will remain substantially poorer than other leading world economies for a long time to come.

This growth trajectory is very different from the experience of Britain, the US and other established economies. As such, speculation about the impact of the emerging economies upon global power politics should be kept to a minimum. It would be unwise to use the rise of nations during the nineteenth and twentieth centuries to provide a guide to the rise of the emerging economies in the twenty-first century.

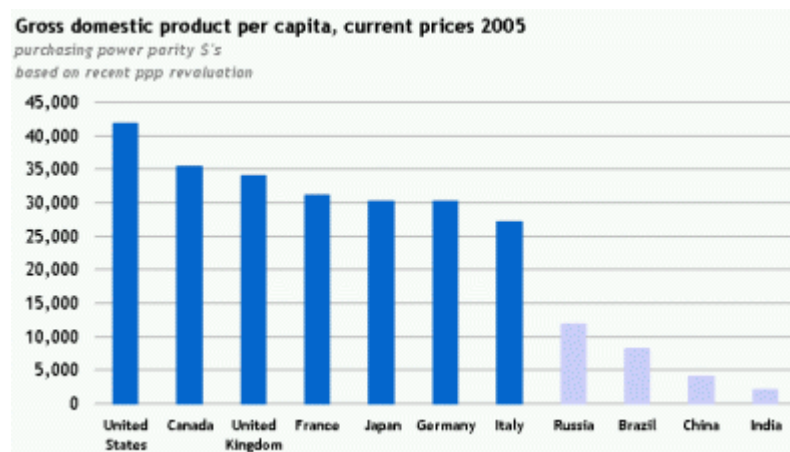
The emerging economies' potential impact upon global institutions and political power is far from clear. What we can say is that the story of the rise of the emerging economies is of the rapid spread of wealth and modernity to the world's poor rather than of a simple shift in power politics.

### **The growth of the emerging economies so far**

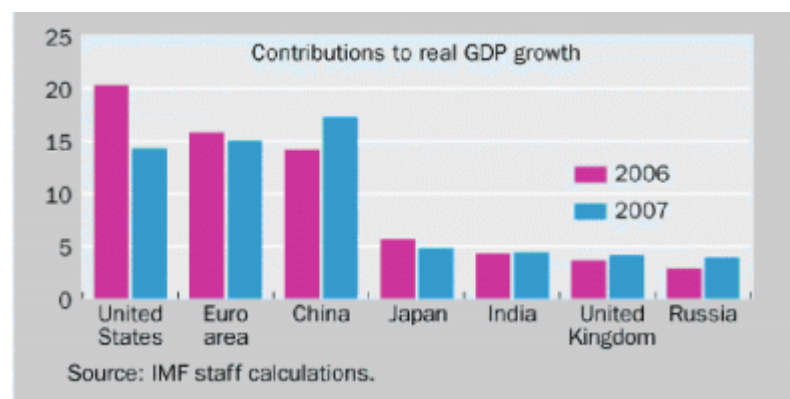
The Group of Seven leading industrial nations (or G7, made up of the US, the UK, France, Germany, Italy, Japan and Canada) dominates the global economy – by almost any measure. These economies, in particular the US, are the primary source and destination of most foreign direct investment, trade flows and much more.

Workers employed in the factories and offices of these economies are more productive than their counterparts in the Pearl Delta or Mumbai. And, since the International Monetary Fund (IMF) recently recalculated the adjustments needed to convert accurately the Chinese renminbi and the Indian rupee into the US dollar (rather than relying on market exchange rates), it has become clear that the wealth

divide between the rich world and the developing world is even larger than was previously thought (1). The gulf between the developed nations of the G7 and the emerging economies of the BRICs (that's Brazil, Russia, India and China) can be clearly seen in the chart below. It compares the annual income per capita in PPP dollars – dollars that have been adjusted for local price differences.



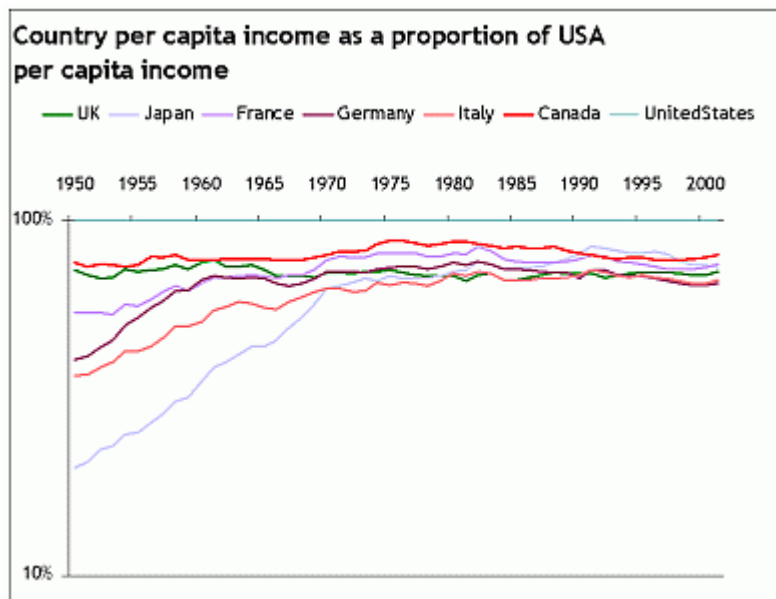
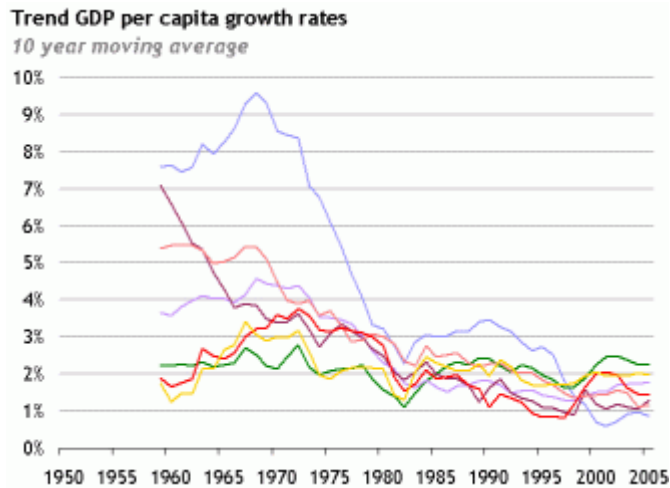
Where things have really changed is the degree to which growth in the developing world now impacts on world growth. In 2007, for the first time, China, the largest and most dynamic of the emerging economies, contributed more to the growth of the world economy than did the much larger economy of the US. This milestone may have come a year or two early thanks to the slowdown of the American economy towards the end of last year, but the trend is clear – the emerging economies have become the main engine of growth for the world economy (2). This shift can be seen in the chart below, which shows China's contribution to world growth increasing to almost 17 per cent in 2007, while that of the US falls below 15 per cent.



In the second half of the twentieth century, the G7 economies converged on an averaged growth rate of around two per cent per annum per capita as the per capita incomes of the G7 have approached American levels. While the US economy will slow down in 2008, and its partners in the G7 will perform little better, there is no sign that this two per cent per annum per capita average will change dramatically (see below). In fact, the most striking development to be found in the growth rates of the developed world is the reduced volatility of the rates of growth around this mean. That China has taken the mantle of fastest growing economy from the US, other than

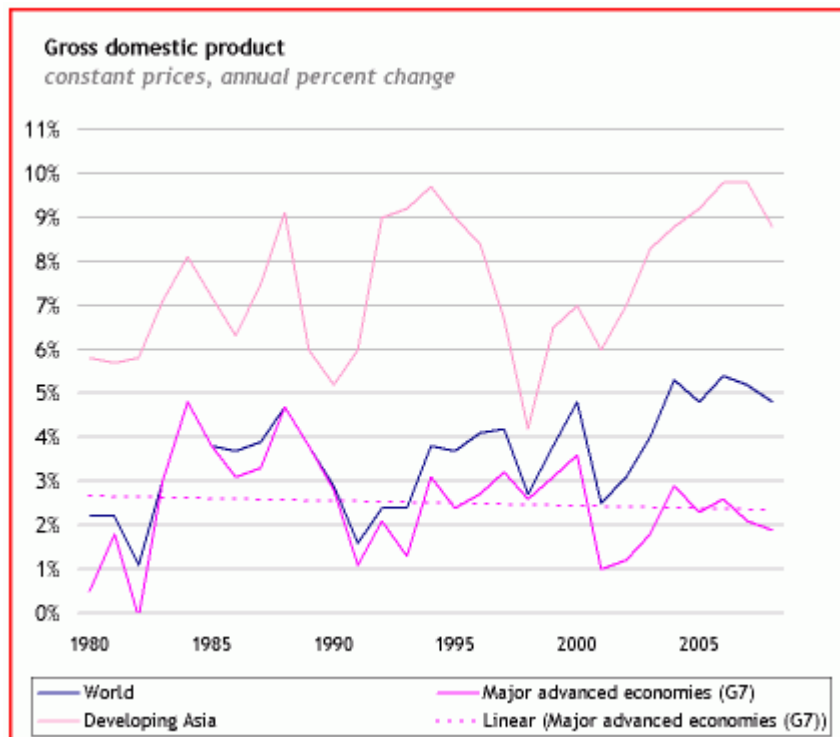
in the timing, is not the result of America's sluggishness, but of the strength of the dynamism outside of the developed world.

The first chart below shows how the economies of the G7 that began the postwar period with greatly divergent growth rates have converged around lower growth rates in recent years. This trend is mirrored in the next chart. The economies that started the period with unproductive, low-income economies initially achieved higher rates of growth. As these economies approached income levels seen in the US, their GDP growth rates declined to American levels.



For the past 30 years, China, along with other smaller economies, has been consistently growing at rates that were double or triple the rates to be found in the developed world. The impact that this growth initially had on the world economy was barely noticeable. Until the early 1990s, the G7 dominated the world economy to such an extent that world economic growth was practically identical to the growth in the G7 economies. From the early 1990s onwards, the effect that China and the other developing economies of Asia were having on the global rate of growth became

perceptible. In this chart, the close match of World GDP growth and the GDP growth rate of the G7 economies can be seen coming to a close in the early 1990s.



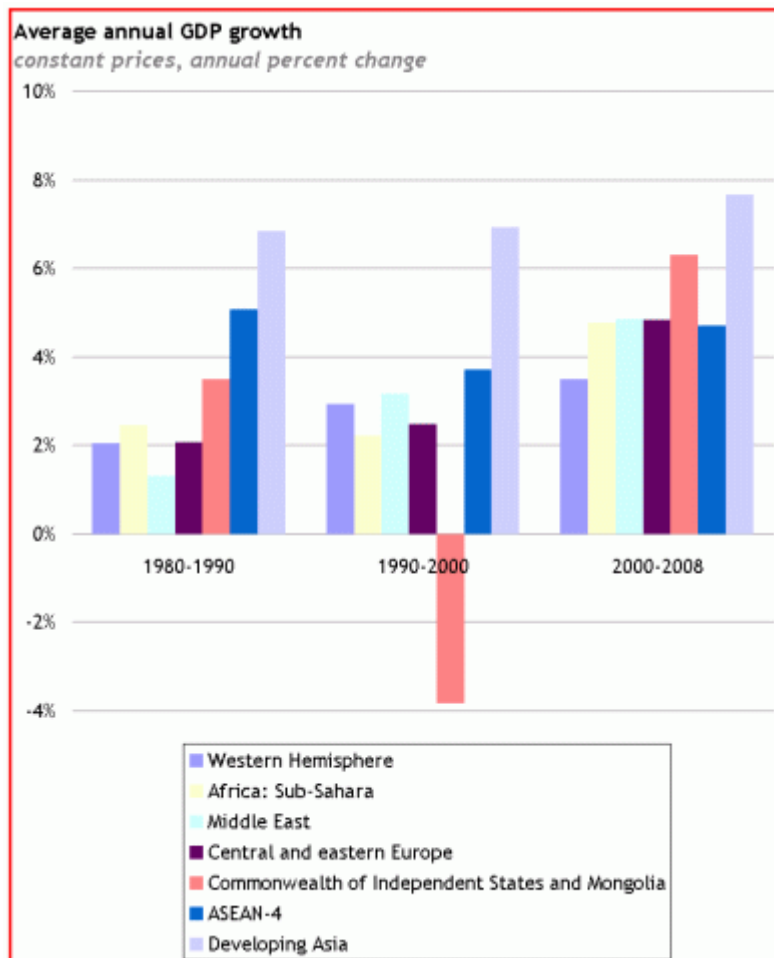
There were two reasons for this change. Firstly, the individual countries themselves were becoming bigger - the compound effect of years of 10 per cent growth. Secondly, the number of countries that moved from Third World stagnation to dynamic growth increased.

The cumulative effects of growth rates that average near 10 per cent are staggering. The size of an economy will double every seven years, triple every 12 years and quadruple every 15 years. This process meant that China's economy grew ten-fold in under 30 years. Expansion that had taken the old economies of the West the better part of a century to achieve was taking place in a few decades in East Asia. Countries seemed to emerge as players in the global economy almost over night. As these economies grew, so their growth carried more weight in the global economy.

The impact that the growth of the Developing Asia economies was having on the global rate of growth can clearly be seen in the chart above: from the early 1990s, the rate of growth of the world economy began to be pulled upwards, away from the G7. The influence of the Asian economies comes abruptly, if temporarily, to a halt as the financial crisis of 1997-98 dramatically reduced growth in these economies and the collapse in exchange rates reduced their weight in the global economy in dollar terms.

But what has characterised the latest period of expansion is not merely more of the same. The high rates of growth that were found almost exclusively in East Asia began to spread and, as they did so, to become more resilient to external shocks. The slow growth and volatility that has characterised the developing world for much of the twentieth century appears to be a thing of the past. The chart below shows just how widespread high rates of growth have become in the initial years of the twenty-first

century. Even Sub-Saharan Africa, the sick man of the global economy, has experienced unprecedented levels of consistent and rapid growth. This has led many to refer to countries within this once-blighted region as the ‘new frontier economies’. More significantly for the global economy, Russia has recovered from a decade of catastrophic collapse and deindustrialisation. This can be seen in the negative average growth rate between 1990 and 2000 for Commonwealth of Independent States and Mongolia in the chart below.



The presence of so many regions exhibiting strong, sustained growth has created novel, reinforcing dynamics in the global economy. While commentators in the developed world worry about the continuing effects of the credit crunch and predict muted growth in the emerging economies as a consequence, a key change in the dynamic of the global economy is often overlooked: the absence of any real fears that the developing world will return to the volatility and sluggish growth of the past. Even Africa seems immune to continued rises in oil prices which in the late 1970s were blamed for bringing on the ‘lost decade’ in which many economies in Africa experienced either no growth or negative growth.

### Decoupling

There has been little drying up of credit available to the emerging economies or even the new frontier markets. A slowdown and even recession in the developed world is expected to have a relatively limited impact upon emerging economies. These two

facts combined have led some commentators to raise the idea that the emerging economies have finally ‘decoupled’ from the developed world. Partly the idea of decoupling is that the emerging economies can rely on separate sources for growth given a slow down in the developed world. Despite the implication of separation that ‘decoupled’ implies, the notion also embodies the idea of integration. The degree to which the emerging economies are resilient to a slowdown in the developed world reflects the extent to which they have become integrated within the wider global economy. Added to this integration is the potential to grow, implied by the purchasing power of a burgeoning middle class, combined with large government reserves, ready to be spent to prop up flagging demand from elsewhere, that characterise the largest emerging economies.

The potential fallout that a slow-down in the developed world will have in the emerging economies in the coming months is still unclear. What is clear, however, is that the resilience that emerging economies do have is derived not from their ‘decoupling’ from the world economy, but from their deeper integration into it.

The extent of the integration of the emerging economies within the wider global economy can be seen by looking at the ‘global imbalances’ that have been created as the emerging economies have rapidly expanded recently.

The talk of global imbalances normally centres on the funding of the American consumer by the Chinese. In a balanced global economy, Americans and Chinese would consume the same value of products and services as they produce. In an unbalanced world, the Americans have been consuming more than they produce and the Chinese have been consuming less than they produce. The imbalance is characterised as increasing liabilities in the United States - in the form of consumer debt - and increasing assets in China, in the form of foreign exchange reserves. It is not hard to see how this imbalance may be unwound by the restriction on personal credit in the United States and other developed economies. At the same time as the American consumer is beginning diligently to pay off those credit cards, the Chinese are converting their foreign exchange reserves into equity stakes in the major Wall Street banks - taking advantage of the banks’ need to raise capital in order to support weakened balance sheets. On top of this, the prospect of a US recession is causing the dollar to fall, pumping up exports while devaluing the \$1.4trillion of foreign exchange reserves that the Chinese hold.

The growth of the emerging economies, unlike the initial growth of the developed world, has been fuelled to a great extent by dramatic increases in trade. While Europe, America and even to some extent Japan, could follow England down the path of industrialisation by initially relying on the purchasing power of their own domestic populations, this option to a large extent has not been open to the emerging economies – their populations were either too poor or too small. When a country did attempt a route of domestic-led growth, as with India, the result was one of stagnant growth rates. The jury is still out as to whether Jawaharlal Nehru laid the foundations for India’s subsequent growth or delayed development, but India is the successful exception that proves the rule (3). The second half of the twentieth century saw global trade increase much faster than global production. The new capitalist economies emerged into a world that was more interdependent than ever before. The

‘imbalances’ that we currently see are a reflection of the way in which the emerging economies have harnessed the global economy to support development.

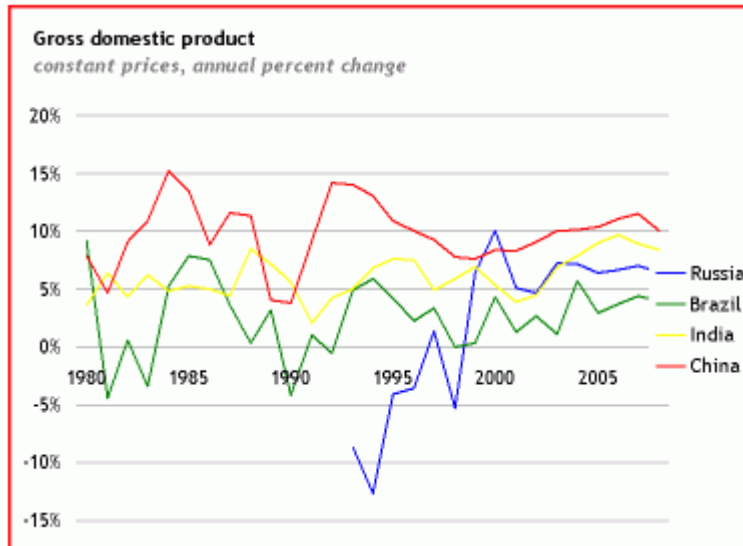
The initial rise of many emerging economies is based on exports to the developed world. Along with the export of goods and services, the emerging economies have exported deflation, in the form of cheaper products and low interest rates. The expansion of production that has resulted from the incorporation of much of the developing world into the global economy has led to both a boom in commodity prices and a reduction in inflation – world inflation has been under five per cent for a decade, while oil price inflation has averaged almost 25 per cent. Low inflation and low interest rates in the developed world are largely responsible for the Non-Inflationary, Consistently Expansionary (NICE) economic environment for which UK prime minister Gordon Brown likes to take credit, while the commodity boom is largely responsible for much of the development in Africa and other resource-exporting regions, for which the World Bank and the IMF so like to take credit. In this way, the rise of the emerging economies has not only directly impacted upon global growth through the growth of their own economies, but has also supported the fledgling new frontier economies and the more mature economies of the developed world.

The rise of the emerging economies is also the story of the BRICs, the four largest emerging economies: Brazil, Russia, India and China. In 2003, the Wall Street bankers Goldman Sachs produced a report forecasting the future growth of the four largest emerging economies from an investor’s point of view – the term BRIC has since become common parlance. The inclusion of the four economies in the study was based on more than their size alone. Goldman Sachs argued that the four economies represented what could be regarded as a coherent economic bloc distinct from the G6 (the G7 nations minus Canada) (4). The four economies included a balance of resource dependence and resource abundance, manufacturing, services, agriculture and export of raw materials – both energy and minerals. On top of this was the sheer weight of their populations. The consequence was the likelihood of increasing ties between these economies that did not include the developed world.

This is exactly what we have seen as trade and investment increasingly flows between the BRICs and from the BRICs to other developing economies (5). The Indian prime minister’s recent visit to China to discuss the growing relationship between their two countries is one example of this development. But interdependence of developing economies goes far beyond the top four. One of the most remarked upon developments of recent years has been the increasing presence of China, and to a lesser extent India and Russia, in Africa (6).

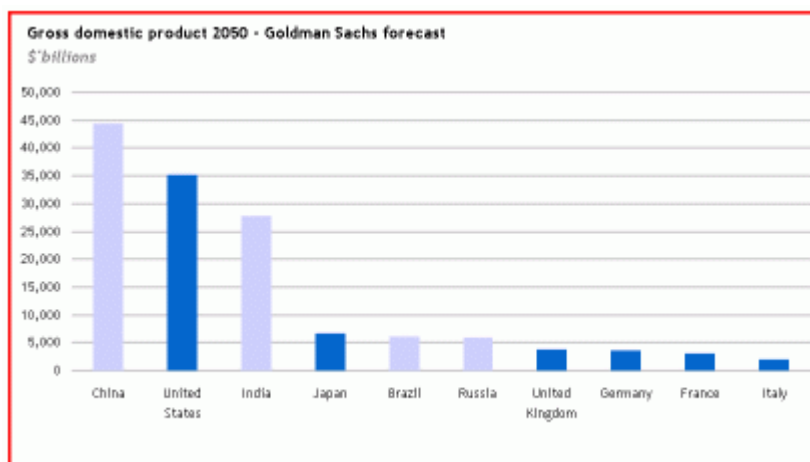
Following the credit crunch, the phenomena of the BRICs, the BRIMCs (including Mexico), the Next Eleven and even the G20 - in other words, the rise of a layer of growing countries with mature, developed economies - is a major stabilising development in the world economy today (7). Even as the global imbalances that were created in the initial stages of the development of the emerging economies begin to unwind, the emerging economies remain more resilient than the developed world. Much of the responsibility for the benign economic environment upon which the relative stability of the developed world has rested can be attributed to the inclusion of the developing economies into a more integrated and interdependent global economy.

The stability of the BRICs as they converge around growth rates double or triple those that exist in the developed world (see chart below) is now having a stabilising effect on the developed world in the current crisis (8). The ability, for example, of the Sovereign Wealth Funds (state-owned enterprises charged with managing a country's foreign exchange reserves or receipts from oil/commodity exports) of China and the oil states to recapitalise the Wall Street banks has mitigated the impact the credit crunch is having on these financial institutions (9).



### Future growth of the emerging economies

The emerging economies are having a profound effect on the way in which the global economy operates, providing both dynamism and stability. So are the emerging economies set to replace the old G7 as world leaders, both economically and politically? While the G7 still dominate the global economy, the BRICs are closing the gap fast and are even now comparable in size to all but the largest member of the G7, the United States. Goldman Sachs forecast that by 2050 only the United States and Japan will be among the world's six largest economies in US dollar terms – and the largest economy will be China, not the United States, as the chart below shows.

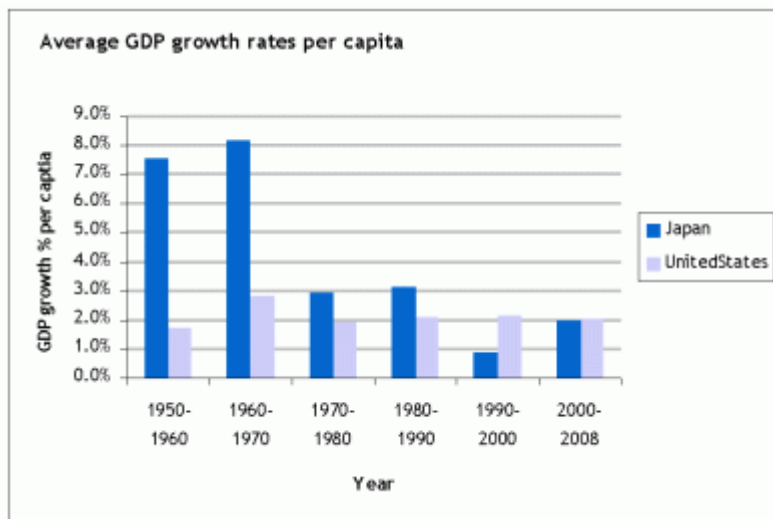


The exact date on which China replaces the US as the world's largest economy is uncertain, but barring a major catastrophe it will happen at some point before the middle of the century. To understand the impact that the growth of the emerging economies is having on the shift in the global balance of power, it is worth asking why it is almost inevitable that China will soon surpass the US as the greatest economic power.

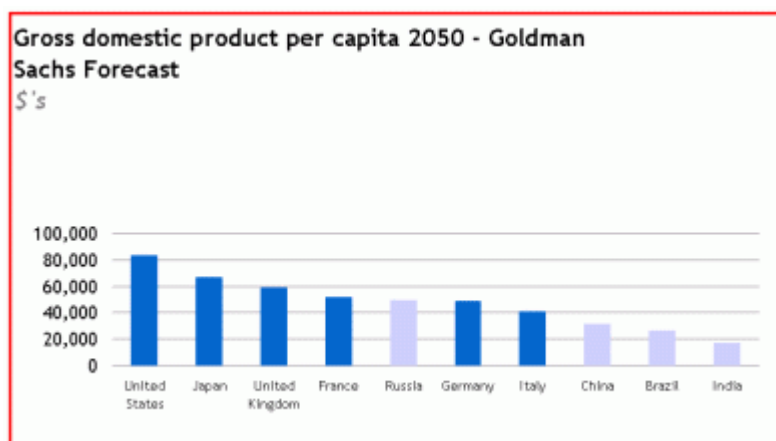
The emerging economies can surpass the rates of growth seen in the developed world not because they are economic leaders but precisely because they are *not* economic leaders. The emerging economies are in the early stages of what is a history-making 'catch-up' with the developed world. The top chart in this article shows just how far behind the developed world the BRIC nations currently are in terms of per capita GDP, even accounting for the lower cost of living in developing countries, and hence how far they have to catch up.

It is the 'catch-up' effect that is providing such high rates of economic growth. The nature of the growth that is taking place is easily hidden by simple numbers such as the annual percentage increase of gross domestic product (GDP). The initial move of populations from rural poverty to urban squalor generates massive growth rates, as does the shift from urban squalor to 'middle-class' suburbs (in this case, 'middle-class' means having an income of \$3,000 or more). The ability of peasants to move to a city and find employment in a factory that is competing in the mass production of textiles is an enormous step. While it took the economies of the developed world decades if not centuries to make the transition from rural economies to industrial societies, it takes only a train ride in China. But for the new factory workers to then go on to compete in the design of electronic consumer goods is another matter. This is not to say that it will not happen - there is evidence to suggest, particularly in India, that this is already happening. But the steps higher up the value chain are harder to achieve. Evidence to this effect can be seen by looking at the experience of nations that have caught up and are now part of the developed world.

Japan provides a sober reminder that being out in front can be harder than following in the wake of others. It is often forgotten that before Japanese multinationals dominated electronics and mass car production, Japanese industry was based upon the production of cheap textiles. As Japan moved from low productivity industries to cutting-edge technologies, the rate of growth of the economy declined as further productivity increases became harder to achieve. The comparison of Japan and the US throughout the postwar period to today shows how Japanese growth slowed to the more consistent levels seen in the US. The chart below demonstrates this trend - the initial high rates of growth that Japan enjoyed did not last. Moving from one industry to the next provides a greater leap in productivity than developing new processes, products or technologies from scratch. The move from one industry to another, and so on, up the value chain allows a country to capitalise in a matter of years on developments that have taken others decades or even centuries to achieve.



By 2050, projections indicate that of the four largest emerging economies only Russia is expected to have reached living standards comparable with the developed world (10). These projections are shown in the chart below. On a per capita basis, the US will still be three times richer than the economic giant China. What is more, by this stage growth rates in the developing world would have levelled off to rates close to those predicted for the developed world. The BRICs will still be far poorer than the G7 by the time the catch-up effect loses its power to generate growth. Under this scenario, the emerging economies are set to remain as perpetual ‘also-rans’ (see chart below). One of the most remarkable aspects of the US economy is the way in which it has consistently maintained levels of economic growth surpassing its closest rivals. The economic leadership that is demonstrated by the US is built upon almost total dominance in the most advanced and the most productive industries. It is far too early to tell whether China or India can provide the world with this level of leadership – certainly 50 years seems too short a timescale for such an achievement.



As well as hiding the ‘catch-up’ effect, double-digit growth rates also hide the structural difficulties that are being generated by the growth of the emerging economies. The growth model of each member of the BRICs comes with its own obstacles to be overcome:

- **China**

To a large extent, Chinese industry is dominated by low-productivity, labour-intensive manufacture. The bargain that the Chinese elite has struck with the population in exchange for political legitimacy rests on the ability of the economy to generate enough jobs to absorb the continuous stream of workers flocking to the cities. As has been noted by many commentators, the Chinese job-generation machine provides high headline figures of economic growth, but hides much waste and inefficiency. Further down the line, there is the spectre of a glass ceiling to Chinese competitiveness. To move from a manufacturing model that is integrated into the supply chain of WalMart and the production lines of more advanced industries in the developed world to one that challenges the developed world for dominance is a step that may not be so easy to take. It is easy to compete with Mexico for access to US markets, but harder to compete with Silicon Valley.

- **India**

One remarkable aspect of the Indian growth story is the way in which it has left rural poverty and ignorance untouched. Even by the low standards of the developing world, rural poverty and illiteracy are rampant in India. In the midst of a population where one-in-three people cannot write their own name, there has developed an international information technology and service industry that relies on the continued supply of highly educated graduates. Many commentators talk of India's demographic boom – a relatively young population that should provide a boost to growth rates decades after the other members of the BRICs have slowed to the levels of growth seen in developed nations today. The truth is that several hundred million middle-aged illiterate peasants will not provide a boost to India's call centres and research and development laboratories, but will present political and logistical problems for a country geared to service a slim, if growing, middle-class elite.

- **Russia**

That Russia and Brazil are included in the exclusive club of the BRICs speaks more of the impact that India and China are having on the structure of the global economy than it does to the dynamism of these two nations.

Russia's reliance on extractive industries during the 1990s provided the basis for the enrichment of an objectionable oligarchy during a general economic collapse. Now that the effects of the Chindian (Chinese and Indian) commodity boom is being felt, and with the oligarchs in prison, this same growth model has turned the Russian government into what some now refer to as the world's largest holding company run by former KGB agents. There are few jobs to be found in the capital intensive industries in which Russia specialises. These industries are entirely dependent upon the commodity boom. The inclusion of India and China into the global economy may have structurally changed the dynamics of commodity prices – but an economy built on such historically volatile foundations must be a cause for concern.

- **Brazil**

The relatively slow growth rates of Brazil – barely above those seen in the developed world - indicate the limitations of an economy that has the rural poor as its backbone. There are limitations for further productivity increases in agro-businesses that are not found in other economic activities. Agriculture is a sector that is associated with diminishing returns and is at the mercy both of the international markets and just general bad weather. While it is true that Brazil has recently seen a doubling of foreign direct investment, increasingly directed towards the manufacturing sector, the reality is that the dynamism of Brazil and Russia is to be found in the industries and populations of India and China.

To highlight some of the problems that lie along the path of development for the BRICs is to recognise that what is taking place is a human endeavour rather than an inevitable tectonic shift. Notions of the rightful place that the ancient civilisations of China and India should occupy in the modern world or of sheer demographic weight will not overcome the obstacles facing the emerging economies. If the Chinese and American growth rates were simply extrapolated 50 years, China's economy would end up more than 10 times the size of that of the United States. This will not happen. Lessons from the growth of earlier economies along with a more sophisticated understanding of the elements that are hidden behind the GDP growth figures demonstrate this. It is important to engage in such reasonable speculation as Goldman Sachs provides in order to gain at least this level of knowledge. But more than this, it is important to recognise that while we know what extreme scenarios will not occur, we do not know how the emerging economies will ultimately develop.

The analyses of Goldman Sachs and others highlight some of the opportunities and problems facing developing nations, and guard against simple extrapolation of recent high growth rates. They do not account for the impact the emerging economies will have on the way in which the global economy and global politics will operate. Such predictions see the emerging economies as lumbering, purposeless giants in a sea of numbers. They are investment guides after all, and should not be used to shape our political understanding of the shape of the world to come.

The economic and political power shift that dominated the twentieth century – the switch of leading capitalist power from Britain to America and the ideological conflict with Stalinist Russia – bears little similarity to the near future as the analysis so far demonstrates. America took the lead from Britain in all spheres, not merely total weight of GDP. Despite the clear differences between the growth of developing nations and the rise of America as a superpower, much discussion on the topic is based upon notions of confrontational self-interested power politics and global hegemony that seem more appropriate to the Cold War than to the novel dynamics of the twenty-first century.

As has already been noted, the rise of the emerging economies is a story of increased interdependence – both among developing nations, but also between the developed world and the developing world. The rise of China and India is the story of their inclusion into the supply chains and production processes of the developed world rather than a story of the competitive threats they pose. Just as the purchasing power

of the developed world has supported the growth of the emerging economies, so the emerging economies have been massively important in supporting an historically unprecedented stretch of continued economic expansion in the developed world. The notion that the dynamics of the emerging economies should be understood in terms of the decline of the West and the rise of the East misses this important aspect: the rise of a more stable, interdependent and robust global economy and the inclusion of the developing world into a global division of labour.

The second novelty that is often hidden by reference to future unspecified growth is the phenomenon of 'rich-poor' countries. Commentators like to play guessing games over the year China will surpass the US in terms of total size of GDP, normally quoted at over-valued price purchasing parity (PPP) exchange rates rather than market exchange rates. 2015 is a date sometimes still used as the turning point. Given that America's economy is currently four times the size of China's, this date is meant to shock more than it is meant to inform. These same people are less exact on the date by which the average Chinese citizen will be wealthier than their American counterpart. The reason for this omission is that there are no indications yet that this will happen. Instead, we are presented with the rise of the middle class in the developing world. This middle class would be unrecognisable to those who discuss the implications at sophisticated dinner parties. Earning over \$3,000 (£1,500) annually is enough to gain membership to the global middle class. This would barely keep the average American in skinny lattes. So while China will surpass the US in total weight of GDP, there is no sign yet that China will become a global leader in any other sphere.

This is not to play down the historic significance of the transformation of entire societies that is taking place today. In terms of the vast creation of wealth and the speed at which hundred of millions of people are leaving the fields and joining modernity, the rise of the emerging economies is a far more dramatic process than even the Industrial Revolution. For this reason alone it should be welcomed and celebrated. But as the Chinese and Indians are often keen to point out, they are still developing countries and will be for some time yet.

There is no doubt that the rise of the BRICs will change the international political landscape of the twenty-first century, as they have already transformed the global economy. But in our excitement to predict 'all change', it is easy to ignore the particular problems that face the world's largest developing nations. For the moment, and for the foreseeable future, the attention of the leading emerging powers, India and China, is directed internally and focused on the myriad problems and challenges that rapid development and continued poverty imply. The potential shift in the global balance of power is far from clear. The story of the rise of the emerging economies is of the rapid spread of wealth and modernity to the world's poor rather than of a shift in power politics.

(1) [A less fiery dragon?](#), *The Economist*, 29 November 2007

(2) [Emerging markets main engine of growth](#), *IMF Survey Magazine*, 17 October 2007

(3) See [For richer and for poorer](#) by Paul Collier, *Prospect*, June 2007 ; [The Washington folly](#) by Erik Reinert, *Prospect*, June 2007

- (4) See the Goldman Sachs [website](#)
- (5) [China + India: the power of two](#), *Harvard Business Review*, 1 December 2007
- (6) See [There is no new scramble for Africa](#), by Stuart Simpson, 4 December 2007
- (7) Bangladesh, Egypt, Indonesia, Iran, Mexico, Nigeria, Pakistan, Philippines, South Korea, Turkey, Vietnam
- (8) [China boom 'cushions world slump'](#), BBC News, 9 Jan 2008
- (9) [Sovereign funds win beneficial deal terms](#), *Financial Times*, 15 January 2008
- (10) See the Goldman Sachs [website](#)
- (11) [China has further to grow](#), *Financial Times*, 12 April 2005

reprinted from: <http://www.spiked-online.com/index.php?/site/article/4390/>