ISAS Working Paper

No. 107 – 10 May 2010

469A Bukit Timah Road
#07-01, Tower Block, Singapore 259770
Tel: 6516 6179 / 6516 4239
Fax: 6776 7505 / 6314 5447
Email: isassec@nus.edu.sg
Website: www.isas.nus.edu.sg

Asia in the 'Catch-Up' Game: Part 2[1]

Shahid Javed Burki[2]

Executive Summary

Two developments, the first decades old and the second very recent, have reshaped and are reshaping the global economic landscape. The first was the process of globalisation that reduced the distance among different economies in the world, not in the physical sense, but in the sense of easy flow of capital, trade, information and technology. Globalisation has produced a global economy, the like of which the world has never known and the process will continue to move forward the global economy.[3] The future course of the world economy is one of the main issues addressed in the study. The second development was what economists and financial experts call the Great Recession of 2008-09 to distinguish it from the Great Depression that took such a heavy toll in the 1930s. What was 'great' about this particular downturn in economic activity was that its origins were not in the normal working of the large economies that produce trade cycles with some frequency. The slowdown that now seems to be winding down was great for several reasons. The ferocity with which it

---

[1] This is a revised version of an earlier draft which was discussed at an ISAS seminar, 'Asia in the "Catch-Up" Game' held on 9 March 2010. Several helpful comments and suggestions made by the participants at the seminar have been incorporated in this version. The first part of this paper appeared as 'Asia in the "Catch-Up" Game: Part I', *ISAS Working Paper 106* (9 April 2010), www.isas.nus.edu.sg/Attachments/PublisherAttachment/ISAS_Working_Paper_106_-_Email_-_Asia_in_the_Catch-Up_Game_(2)_13042010114904.pdf

[2] Shahid Javed Burki is a Visiting Senior Research Fellow at the Institute of South Asian Studies (ISAS), an autonomous research institute at National University of Singapore. He was former Vice-President of the World Bank, and former Finance Minister of Pakistan. He can be contacted at sjburki@yahoo.com.

[3] Globalisation has attracted a great deal of academic and policy attention ever since the process was recognised as an important contributor to changing the shape and structure of the global economy. It has been studied from both the left and right sides of the political spectrum. For the former, see Joseph Stiglitz, '*Making Globalization Work'* (New York, W.W. Norton, 2002). For the latter, see Jagdish Bhagwati, '*In Defense of Globalization'* (New York, Oxford University Press, 2004) and Martin Wolf, '*Why Globalization Works'* (New Haven, Conn.: Yale University Press, 2004).

struck; it took the form of an economic tsunami that not many had predicted. It hit many shores. It was caused not by the normal ups and downs in economic activity but by misplaced faith in the rationality of the markets. And it is likely to change dramatically the structure of the global economy. It is this final aspect of the Great Recession that is the subject of this inquiry. Going back to the analysis of 'catch-up' offered by Alexander Gerschenkron, the premier economic historian of the 20th century, the role the state plays in the process acquires special significance. In this regard, it is particularly important to note what governments can do to better the lives of their citizens. The government's role as an economic player was relegated to the back benches in the 1980s by the economic philosophy that accompanied Ronald Reagan to the White House. Called *The Washington Consensus*, this view left the private sector to its own devices, even to regulate itself. Forced on the back-bench, the state remained there until it was called upon to act again to save the world economy from collapsing in 2008. Summoned back, the state acted impressively in both developed and developing countries. China brought the state back with vengeance. The United States (US), by intervening in the financial markets and automobile industry, dramatically increased the role of the state. Many other countries, including India in Asia and the European Union (EU) in the West, followed the same path. It is interesting to note that even the Chinese had succumbed for a while to a weaker version of *The Washington Consensus*. There is considerable irony in the fact that an avowedly socialist economy was tempted for a while to adopt some aspects of neo-liberalism for managing the economy. With the state having roared back to life, what will it do to shape the character of the Chinese economy? This is yet another question in this exercise.

Taking a cue from those who have studied various episodes of 'catch-up' in economic history when some of the economies that lagged behind 'caught up' with the leader, this paper investigates the latest such development. This involves China, which some time in 2010 is expected to become the second largest economy in the world, overtaking Japan, which held that position for several decades. This is a particularly relevant occurrence for Asia not because an Asian economy is replacing another. This is significant because the structure of the Chinese economy and its character are changing in ways that will matter enormously for the rest of Asia. While Japan is from Asia, after its economy became 'developed', it joined the ranks of those that were similarly placed. Japan's linkages with Asia were weak; but those of China are becoming strong. A good indication of this is the inauguration of the China-ASEAN Free Trade Area on 1 January 2010 that will have profound consequences for the economies in its periphery.[4]

Unlike some of the earlier 'catch-up' instances, China, having almost overtaken Japan and expected to bypass the US in the next several decades, will remain a relatively poor country

4 Not many observers of the Asian scene believe that the regional arrangements are working as well as suggested by their proponents. See, for instance, 'South-East Asian Summitry: Distant dreams', *The Economist* (31 October 2009), p.37.

dependent on the rich for markets and technology. This introduces an entirely new dimension in the 'catch-up' game. For many decades to come, the global economy will be dominated by two economies that will not compete as much as Britain and France did during the first 'catch-up' episode a couple of centuries ago, but complement one another. Notwithstanding the current exchange of difficult words between Beijing and Washington, the global economic architecture can neatly arrange itself into three tiers: the US and China at the top (the G2); a number of secondary powers in the middle (a reformulated G20); and the rest of the world forming the base of the pyramid. Those who believe that such a system dominated by two economies will not be stable derive the wrong lesson from the Cold War when for four decades the US and the Soviet Union confronted one another, sometimes with murderous intent. It was only the mutually assured destruction made possible by the possession of thousands of nuclear weapons by the two sides that prevented the globe from being reduced to a giant mushroom cloud. It is not necessary that a great power must always beat back competition and seek total domination. When competing powers need each other as do the Americans and the Chinese, they will learn to work with another. This is expected to happen within the context of the architecture outlined in this paper. But the development of such architecture will need deliberate action by some of the more important governments in the world.

While mutual dependence is likely to create equilibrium in the global economy and also keep the political system in balance, can the same be expected in Asia? The continent has not one, or two, but three great economic powers. While Japan does not seem concerned with the second rank that it is soon likely to assume in the continent in terms of the size of the economy, will India be content to be the third? More importantly, will it be prepared to be relegated to the emerging second tier in the hierarchical structure for managing global economic affairs? Answering these questions will require deep and intensive research. For the moment, it is important to underscore that for India to gain the economic and political stature it desires, it will need to achieve a number of things: tranquility around its borders; an economic system that delivers to the less advantaged segments of the population, particularly in terms of education and skill development; development of physical infrastructure that can support a rapidly growing and modernising economy; and an economy that is more outward-oriented so that it can take full advantage of the rapidly changing systems of trade and production. If it is able to achieve most of these things, there is no reason why some time in the future the system's apex cannot expand from the G2 to the G3.

Introduction

Continuing from the analysis presented in Part 1 of the paper, the first section of this paper takes up the question of some dramatic changes in the structure of the Chinese economy and how these might impact other parts of the globe. This discussion will be centred on some of the profound demographic changes occurring in China that are often overlooked from the analyses of China's future development. In the area of demography, it is important to note not only the size of the Asian populations but also their youth and mobility. It is inevitable that the increasingly labour-deficient economies of the West will turn to Asia for performing a number of services. This was the subject of Thomas Friedman's book, *The World is Flat.*[5] India has taken the lead in this regard with China also, to some extent, and with Pakistan 'catching up' fast. Even less analysed and understood is the pattern (more correctly the patterns) of urbanisation in Asia. These will have profound consequences for the development of the Asian and global economies.

The next section examines the rise of China and the decline of Japan as powerhouses in the global economy. The paper will argue why China's rise will matter more for the Asian economies than the earlier take-off of the Japanese economy. The section thereafter will briefly explore some of the current thinking about the state of the global economy according to which the world may have entered a period of extreme economic and political turbulence as some of the major powers reposition themselves in the global system. Many analysts maintain that the 'catch-up' either begins with or ends with major conflicts. This certainly happened in the 20th century. However, in the present instance, it will be argued that because of the process of globalisation – by which is meant the growing linkages among various world economies – the transition to a new global order is likely to be much smoother compared to those that occurred in the past.[6]

The section that follows examines the way India is 'catching up' and how it could ascend to the status of a global economic power if it is able to address the problem of poverty, lagging regions and poor relations with the countries in its immediate neighbourhood.

The two sections that follow offer some thoughts on how a new institutional mechanism at the international level may ease the process of transition as it proceeds at an accelerated pace. The process of transition has hastened because of the way various countries have attempted to mitigate the impact of the Great Recession of 2008-09. The final section draws some conclusions from the analysis about the future by taking into consideration the caution offered by Nasem Talib that large but unexpected events ('black swans') can seriously

---

5 Thomas L. Friedman, '*The World is Flat: A Brief History of the Twenty-first Century'* (New York, Picador, 2007).

6 This point of view is forcefully presented by Gregg Easterbrook, '*Sonic Boom: Globalization at Mach Speed'* (New York, Random House, 2009).

disturb the likely movements of nations, regions and the world along expected lines.[7] The terrorist attack on the US on 11 September 2001 was one such event which has had many unexpected consequences. The attack on Pearl Harbor by the Japanese was another such event. It never pays to make straight line projections about the future, especially the distant future.

Dramatic Changes in the Structure of the Chinese Economy and their Impact on Asia

While China has generally followed the model of growth pursued by other 'catch-up' economies of East Asia, including Japan, given the size of the population; geographic spread of the country; the relatively small size of area that can be brought under cultivation; long history of highly centralised state; and the presence of a large Chinese diaspora in many parts of the world, it is inevitable that the country would structurally develop in ways that are different from other parts of a rapidly growing Asia. From the perspective of this paper, four structural changes in the Chinese economy are worth noting that are likely to have profound influences on the way the country reacts with other parts of the world. These are the rapid decline in the rate of fertility; rapid rate of migration and the concentration of the population in a narrow strip of land along the east coast; and rapid change in the structure of industrial production. Finally, the paper suggests that there will be a slowdown in the rate of China's economic growth as the economy matures and the demographic dividend that has contributed to the economy's rapid advance works its way through the system.

There has been a fairly dramatic decline in the rate of fertility in most parts of the globe. According to the United Nations (UN) population division, 2.9 billion out of the world's population of 6.5 billion live in countries with fertility rates lower than the replacement level of 2.1 children per woman in the reproductive age. This number is expected to increase to 3.4 billion out of 7 billion in early 2010, and to over 50 per cent by the middle of the decade.[8] Both demographers and economists now recognise that prosperity brings a decline in the rate of fertility; the opposite of what Reverend Thomas Malthus had postulated a couple of centuries ago. He thought that richer people will have more children and as countries accumulated wealth, there will be an increase in the rate of fertility. However, the population bomb that Malthus thought was placed under the world economy did not explode. Experience has shown that fertility rates drop as annual income per person reaches between US$1,000 and US$2,000, until it hits the replacement level at an annual income per head of US$4,000 to US$10,000 a year. According to one analyst, 'this roughly tracks the passage from poverty to middle-income status and from an agrarian society to a modern one. Thereafter fertility continues at or below replacement.'[9]

---

7 Nassim Nicholas Taleb, '*The Black Swan: The Impact of the Highly Improbable'* (New York, Random House, 2007).

8 United Nations Economic and Social Affairs, *World Fertility Patterns* (United Nations, 2010).

9 'Fertility and living standards: Go forth and multiply a lot less', *The Economist Briefing* (31 October 2009), p.30.

While following this track, China accelerated the pace of demographic transition by adopting the one-child policy in the early 1970s, close to the end of the Mao Zedong era. The country's population is probably 300-400 million less now than it would have been without this policy. While the policy had some dreadful social costs such as large incidence of abortions and female infanticide, 'in its own terms it has worked – 20 million enter the work force each year, instead of 40 million.'[10] This may have benefitted the economy over the short-term but will have unforeseen consequences over the long-term. By accelerating the rate of fertility decline, China will have to deal with some of the problems that ageing population is now posing in Japan and Europe at a much lower level of per capita income. It will also have to quicken the pace at which the economy will transit from the one that relied on cheap labour to capture markets in the West to one that depends much more on using knowledge as the basis of economic development. As it makes this move, there will be consequences for its Asian trading partners, especially those who will still have large number of low-skill labour for several decades to come. The populous countries of South Asia could become the source of the goods and services produced by cheap labour.

Urbanisation is the second area where China will depart significantly from the path traversed by other developing countries. The country's urban future will be shaped by the highly dense development along its east coast, from Dalian in the northeast to Guangzhou in the southeast. Within the next few decades, probably 500 million people will be living in this narrow strip of land with a combined income of US$10 trillion and income per capita of US$20,000 in today's dollars. More than one-half of China's income at that time is likely to come from economic activities undertaken in this crowded bit of land. What will become a ribbon of the national economy could become multinational as well as the strip extends northward to Korea; and southward to Vietnam and Southeast Asia. This development will bring in a massive structural change in the Chinese economy. It will not be possible for the country to maintain land-intensive economic activities. Agriculture will become a smaller part of the economy as will the part of the manufacturing sector that needs a great deal of space. In a relatively new sub-discipline of economics – economic geography – focus has begun to be placed on the impact of density and distance on economic structures.[11] China reliance is likely to increase on countries that are in close proximity and have the physical space to conduct activities that are expensive and difficult in China. This should bring South Asia economically closer to China.

A fundamental change is taking place in the global system of production that will produce unforeseen opportunities for people all over the world, developed and developing. The world is becoming more integrated every day. The factory-based economy is on its way out. Technological improvements mean that parts and components are being produced in places

---

[10] *Ibid.*

[11] The relevance of this discipline for the developing world was discussed in, '*World Development Report, 2009: Reshaping Economic Geography'*, World Bank, Washington DC, 2009.

that have comparative advantages for doing so. China produces Apple's iPods by obtaining designs from the US and 200 parts from different countries around its periphery. Technology is also adding to productivity. Fifteen years ago, Boeing built the 737 airliner in 22 days; it now does so in only 12 days. Twenty years ago, most of the components that produced the 747 airliner were manufactured in the US. The new airliner, the 787, has many parts made in China. One corollary of this kind of approach of an integrated world is that it is not likely to get engaged in another Cold War or such disruptive policies. There is too much to be gained through cooperation than through confrontation for the competing countries to become antagonists.

As countries develop, their rates of growth tend to slow. Annual growth in Japanese Gross Domestic Product (GDP) averaged 10.4 per cent in the 1960s and 5.0 per cent in the 1970s; but only 4.0 per cent in the 1980s and 1.4 percent in the 1990s, according to Goldman Sachs. In the first decade of this century, such growth has been even slower. This is being underscored in order to caution against the acceptance of forecasts of the future based on straight line projections. Based on current growth and currency trends, C.H. Kwan forecast that the Chinese economy could surpass that of the US in 2039 but will then begin to slow down.[12] Would this happen? While some slowing down is inevitable as the demographic dividend is exhausted and the economy matures, it may occur much later than it did for more developed economies. There are still hundreds of millions of workers performing low productivity jobs in China. Once they move into higher productivity operations, they will sustain the rate of growth for several years to come.

Japan and China: Overtaken by the "Kingdom of Bicycles"

Though recent wild swings can delay the reckoning, many economists expect Japan to cede to China its rank as the world's second largest economy sometime in 2010, as much as five years earlier than previously forecast. This would represent a spectacular reversal of historical trends. This would be the first time in the 'catch-up' game that nations have played that a country once 'catching up' is eventually moving in the opposite direction. The per-capita GDP of Japan, which surged past that of the US in the late 1980s, stalled at US$34,300 in 2007; it is now a quarter below America's and is 19th in the world. According to Hiroko Tabuchi, who has studied Japan's relative decline from the perspective of a journalist sensitive to noticing change, both the level of income inequality and the incidence of poverty are on the rise in Japan. Unemployment currently stands at 5.7 per cent, while prices and wages are falling fast. Japan's economy shrank at an annualised rate of 11.7 per cent in the first three months of 2009 before recovering to a modest 2.3 per cent rate of growth in the

---

[12] C.H. Kwan is the author of the forthcoming, '*China as No. 1',* a kind of update of Ezra. F. Vogel's 1979 best seller.

second quarter. Economists expect the Japanese economy to shrink 5.0 per cent in 2009 before returning to anemic growth of about 1.0 percent next year. This was one of the instances when government stimulus did not work. The Japanese economy stagnated as huge public works projects aimed at reviving the economy went toward protecting moribund industries instead of fostering new ones.

There have been many consequences of a weakening Japanese economy. In 1988, Nomura Securities issued a ranking of companies by market capitalisation, and eight of the top ten were from Japan, topped by Nippon Telegraph and Telephone. As of July 2009, not a single Japanese company made it to the global top ten. The list now is dominated by companies based in China and the US; Toyota Motor is ranked 22nd (US$144.5 billion) and only five other Japanese companies are in top 100. Toyota's current quality problems that have resulted in recall of hundreds of thousands of cars all over the world, particularly in the US, will not help the image of the Japanese corporate sector. Individuals are slipping along with the corporations from which they drew their incomes and personal wealth. The richest man in Japan, the retailing entrepreneur Tadashi Yanai, was 76th in the most recent global Forbes list, behind moguls from countries like Mexico, India and the Czech Republic – a far cry from the late 1980s when Japanese industrialists like the railroad tycoon Yoshiaki Tsutsumi were among those at the top.[13]

How are the Japanese reacting to this change in their relative position and what does this mean for the rest of Asia? According to Mure Dickie writing from Tokyo for the *Financial Times*, Japan is coping with the looming change, 'with admirable equanimity'. Leading newspapers have reported the narrowing GDP gap with symptoms of existential angst. Prime Minister Yukio Hatoyama insists he is unperturbed and Japan should aim for an economy "commensurate" with its size.[14] This is not the first time the citizens of a leading nation have had to deal with some loss of status conferred by global ranking. Several looked the other way as China sprinted past them. The British reacted indifferently when China overtook their country in 2006 in terms of the size of its GDP. Germany was largely untroubled as a Chinese statistical revision in 2009 showed it had been ousted as the global three in 2007. That said the trophy the numbers game brings to the way a nation is perceived matters in many ways. As noted below, the rank China has achieved has earned it the top place in the policymaking hierarchy that is now taking shape. Dickie quotes Hirotami Murakoshi, a member of the Diet for the ruling Democratic Party, 'I think it will have a big effect on Japanese thinking. Many people still think of China as the bicycle kingdom.'[15] On the other side of the coin, 'many

---

13 Hiroko Tabuchi, 'China's day arriving sooner than expected', *The New York Times* (2 October 2009), pp.B1 and B2.

14 Mure Dickie, 'Japan calm as treasures status of number two slips away', *Financial Times* (23 February 2010), p.2.

15 *Ibid.*

people in Japan ask whether it is destined to be the next Switzerland: rich and comfortable, but of little global import, largely ignored by the rest of the world.'[16]

In this context, three things are worth noting. The speed with which China has 'caught up' with Japan is without historical precedence. It happened given the large differences in the structural rates of growth of the two countries in the decade and a half after 1995. What quickened the pace was Beijing's response to the economic slowdown produced by the Great Recession of 2008-09. Beijing decided to invest huge amounts of public and bank money in the economy to stop it from slumping. A significant amount of investment was made in improving physical infrastructure, in particular in areas distant from the east coast. In other words, the Chinese were using the opportunity created by the need to stimulate the economy to bring about more balanced growth in the country. They were also attempting to bring the economy closer to those of several of its neighbours. A considerable amount of public money went into improving physical connections with neighbouring countries.

Some examples will usefully illustrate this approach. While investments are being made to improve the Karakoram Highway (KKH) in Pakistan and improve China's access to the port of Gwadar, the Chinese for the moment are focusing on improving their links with Southeast Asia. For instance, the construction of a bridge has completed a road link between Kunming, the capital of Yunan province in the south, with Bangkok in Thailand. Another bridge linking Yunan with northern Vietnam is nearly complete. The airport at Kunming is being upgraded with an investment of US$3.4 billion. All this activity is in one province; other border provinces including Xinjiang that is next to Pakistan, is also receiving considerable attention.[17] What this demonstrates is that the authorities in Beijing are not simply throwing stimulus money where it can be absorbed easily and wherever jobs can be created – the Americans call this the 'shovel' ready approach. In fact, they are converting the need to a geo-political opportunity. This is the major difference between the Chinese and Japanese approaches.

Another difference between the two countries is the way they look at the West and Asia. Largely because of the destruction the Japanese brought upon themselves as a result of the activist path pursued in the period leading up to the Second World War, Tokyo has deliberately followed an insular approach. A defeated nation tends to become passive and that is what happened to Japan once it signed the armistice treaty with the US. Also, the Japanese were much more interested in creating markets for their products in the West, in particular in the US. If the penetration of the Western markets produced problems and appeared that retaliatory action may be taken, Tokyo could encourage the private sector to locate factories

[16] Hiroko Tabuchi, "China's day arriving sooner than Japan expected", *The New York Times* (2 October 2009), pp.B1 and B2.

[17] C.H. Kwan is the author of the forthcoming, '*China as No. 1',* a kind of update of Ezra. F. Vogel's 1979 best seller.

where markets are to be found. Japan thus became a major automobile manufacturer in the US.

The Japanese kept an arms-length relationship with the developing world, including countries in East Asia. The only way they engaged with developing countries was by providing aid – an area in which they were more generous than most Western states. Even here they let the lead to be taken by Western donors. At the time when the author was in-charge of the World Bank's China operations (1987-94), Tokyo was prepared to leave a great deal of policy advice to the Bank. The Japanese were also not interested in financing flashy projects with which the country's name would be associated in the minds of the recipients. China, on the other hand, is happy to be identified with high profile projects. It is well-known in Pakistan, for instance, that the Chashma nuclear power plant was financed and built by China. China was also deeply involved in construction of the port at Gwadar and the KKH. A Chinese company has won the tender to build the extension of the motorway system to Multan in central Pakistan. The Chinese are also continuing to finance highly visible projects in Bangladesh. Iftekhar Ahmed Chowdhury, who had served as Bangladesh's foreign minister for two years (2007-09) mentions, 'China's preference for funding landmark iconic projects' is mostly in the sector of infrastructure as a part of its evolving relationship with Dhaka. He notes that during the visit of Prime Minister Sheikh Hasina to China (17-21 March 2010), the two sides undertook an 'Exchange of Letters on the Construction of the Seventh Bangladesh-China Friendship Bridge (across the Meghna) and the construction of the Bangladesh-China Friendship Exhibition Centre.'[18] Earlier the Chinese had constructed six 'Friendship Bridges' in the country.

Having reached the international scene as an economic victor, China has vigorously pursued its regional and global interests. Some of what it is likely to do, and has already begun doing, irks the US and other Western powers. But, Beijing is unlikely to relent. That said the Chinese are more likely to accommodate the interests of other countries than was sometimes the case with the US when Western powers held unchallenged sway.

With the global production and trading system changing rapidly, the Chinese will want to integrate their economy more fully with those in Asia. Japan, on the other hand, remains involved with the Western economies. This greater Asia orientation will exercise a pull over several Asian economies, not only in East Asia, but also in South Asia. China is also likely to partner with the US in a global system in which the G2 will form the apex, G20 the second tier and the rest the base. Unlike several earlier 'catch-up' periods, especially those involving the European powers, the current one involving China is likely to be relatively conflict free. A reason for such optimism is that Tokyo does not seem interested in contesting China's

[18] Iftekhar Ahmed Chowdhury, 'Bangladesh-China: An Emerging Equation in Asian Diplomatic Calculations', *ISAS Working Paper 105* (31 March 2010). p.8, www.isas.nus.edu.sg/Attachments/PublisherAttachment/ISAS_Working_Paper_105_-_Email_-_Bangladesh-China_Relations_31032010193847.pdf. Accessed on 5 April 2010.

economic rise. According to Gideon Rachman, 'how Japan reacts to this new sense of weakness – exaggerated though it may be – will matter to the whole world. The country's size and strategic importance make it critical to America's Pacific strategy and China's geopolitical calculations.'[19]

Which way are the Japanese likely to go? One answer comes from the analyst quoted above, 'One option would be to assume that China is gradually going to displace the US as the dominant power in the Asia-Pacific region and, therefore, try to cultivate a warmer relationship with the government in Beijing. The alternative would be to hug the US even closer and cultivate warmer relations with other democratic nations in the region, such as Australia, in what would be an undeclared policy of "soft containment" of Chinese power. For the moment, it makes sense for Japan to aim for good relations with both the US and China. In the long run, Japan is likely to face an uncomfortable choice.'[20] But, as this paper suggests subsequently, it is possible for the international community to organise its affairs in such a way that these choices do not have to be made; that individual countries can be neatly slotted into the different tiers of a self-structured system.

South Asia, led by India, as a 'Catching Up' Region

Much of the foregoing discussion was about China 'catching up' with other large world economies. In discussing the Chinese situation, we used the analytical frameworks developed by economic historians Alexander Gerschenkron and Angus Maddison. These emphasised the fact that policymakers in the 'catch-up' countries deliberately set for themselves the goal to draw even with the leading economies in terms of the technological base of their economies and income per head of their populations. They also made use of the state and public policy to move forward, bearing in mind their particular conditions. However, with China entering the 'catch-up' picture, size of the economy also came into play. That had happened once before when the US set its sights in terms of 'catching up' with the European economies. That was in the concluding decade of the 19th century and the opening decade of the 20th.

China's spectacular economic rise was made more noticeable by the sheer size of its population. Now with 1.34 billion people, with per capita income of US$6,500 in purchasing parity terms, the country's GDP is estimated at US$8.7 trillion. With a GDP of this size and growing at 10 per cent a year, China will soon be the second largest economy in the world, when sometime in 2010, it overtakes Japan. But then, there is another billion-plus population country in Asia that has also been growing at a very rapid rate. What are its prospects and will it also 'catch-up' with the other large economies in the world? India, of course, is that country. Should the epithet of 'catch-up' also be applied to it?

---

19 Gideon Rachman, "Why Japan is edging closer to China", *Financial Times* (9 March 2010), p.11.

20 *Ibid.*

India is also a trillion-dollar economy. In 2010, its population is estimated at 1.17 billion and its PPP (Purchasing Power Parity) GDP per capita is estimated at US$3,320. This means that the size of the Indian economy is US$3.88 billion, about 42 per cent that of China's. As in the charts (Part I of the paper)[21] that projected the sizes of the world's largest economies, India has already 'caught up' with a number of other large world economies. However, in our discussion of 'catching up', we have put emphasis not only on the size of the economy but the influence that it has on the world economy. In this respect, India lags behind China for a number of reasons. Among these are its relations with the countries in its neighbourhood. While China has good working understanding with all the countries it borders, India has difficulties with some in its immediate neighbourhood. In the current growth spurt, China is relying on the regional economic structure it has helped build in the East Asian region. The Chinese industrial sector is getting closely linked with that of those in its neighbourhood. Nothing of this kind has occurred in South Asia. That said, it should be noted that New Delhi has begun to restructure its economic relations with one of its more important neighbours, Bangladesh, when Prime Minister Sheikh Hasina visited New Delhi in January 2010.

While India is certainly a 'catching up' economy, public policy will help in laying out the trajectory it must follow in order to join the top tier of the global economic structure. For that to happen, it must sustain a high rate of growth in the years to come; deal with the problem of extensive poverty and skewed distribution of income; offer more incentives to foreign businesses; and carry with it the countries in its neighbourhood. Some movements in these areas have begun. In that context, the government's policy statement made when the budget for 2010-11 was presented is revealing.

Pranab Mukherjee announced the budget on 26 February 2010 and promised that the rate of economic growth was headed towards double digits. He also opened the economy a little bit more to those outside the country who would like to place their bet on an expanding Indian economy. The Indian finance minister was cautious about the international environment in which his country's economy will be functioning. 'While the global financial condition has shown improvement over the recent months, uncertainty about the revival of the global economy remains. We cannot, therefore, afford to drop our guard', Mukherjee said in his Lok Sabha address. The policy statement indicated that New Delhi will not be pulling back on the efforts to stimulate the economy. These efforts had paid off but it was not the time to change the basic economic thrust. There was recognition, however, that making the economy dependent on public sector stimulus was not a viable long-term option.

---

[21] Shahid Javed Burki, 'Asia in the "Catch-Up" Game: Part I', *ISAS Working Paper 106* (9 April 2010), www.isas.nus.edu.sg/Attachments/PublisherAttachment/ISAS_Working_Paper_106_-_Email_-_Asia_in_the_Catch-Up_Game_(2)_13042010114904.pdf

According to the Government of India's estimate presented in the budget, the economy grew at 6.7 per cent for the year ending 31 March 2010. It will follow on this performance by growing at 8.8 per cent in 2010-11. The Finance Minister followed up on his speech in the Lok Sabha with interviews with the press, including one with the Financial Times, in which he said there was no complacency about the economy's ability to climb back on a high growth strategy that will produce GDP increases of 10 per cent a year. However, the lack of a parliamentary majority was an obstacle to moves such as raising the cap on foreign investment in the pension and insurance sectors, and steps to improve governance. The private sector once again will be the driver of growth as the state pulls back after having taken effective steps to stimulate the economy. The state, however, will continue to help the poorer segments of the population by retargetting the subsidies that in their present form go to the more well-to-do segments of the population. Only time and political will, will tell whether the few reforms that were introduced would yield the intended results. According to David Pilling, a long-time observer of the Indian economic scene, 'these adjustments could quickly accelerate into meaningful reallocation of government spending. Equally, they could stall on the hill of special interest politics.'

While emphasising the importance of high rates of growth in its economy, Mukherjee gave some attention to its distributive aspects. The emphasis on redistribution was not new in the Indian way of thinking on economic issues. It was the platform on which the Congress Party was elected in 2009 to another term in office.

Until recently, in fact up to the Great Recession of 2008-09 that shook the global economic system, China and India followed different growth models. China had relied much more on using external markets to develop scale for its industrial system. In that and several other respects, it had followed the East Asian model of export-oriented industrialisation. India, on the other hand, had pursued import substitution for industrialisation for more than 40 years after achieving independence. When it opened its economy to the world outside starting in the late 1980s but more fully after 1991 when then Finance Minister Manmohan Singh had to deal with a serious balance of payments crisis, the Indians continued to be cautious about foreign participation. Although the 'license raj' that owed its existence to Jawaharlal Nehru's socialisation of the Indian economy was dismantled, the participation of foreign capital remained constrained. It was allowed in a limited way into some sectors of the economy. Its involvement in the sectors of finance and retail trade was quite severely constrained. Foreigners were also not encouraged to participate in the development of the social sectors, in particular, education. The Indians, for instance, were now making an effort to open their education sector, but for political reasons still in a limited way. They have indicated, for instance, that new incentives will be offered to private operators from the outside to enter the education market.

The Indian budget also promised a major effort in improving the quality and reach of physical infrastructure. The development of high-class highways was to be given special attention. In the budget for the railways, there was promise that quality of the services provided will be greatly improved by developing high speed railways. Here again, China and India have adopted different approaches. The Chinese, having anticipated that a rapidly developing economy will need a well-functioning transport system, began to invest in highways and railways early on. The Chinese claim that they are now operating the world's fastest train. It connects Shenzhen in the southeast with Wuhan in the country's centre. The Indians are now playing 'catch-up'.

There are other subtle differences in the overall direction of public policy in the two countries. It is growth with continued emphasis on poverty alleviation in the case of India. The Indian leadership emphasises the need to maintain high levels of growth rates while the Chinese leaders are promising to care for the poor. The Chinese policy objectives include considerably greater focus on distribution while maintaining a reasonable rate of growth. There is no explicit reference to distribution in the Indian statement.

The Indian policy statement can be read as more directed at foreign audiences. New Delhi seems anxious to make the case to foreign investors that the country should be a major destination for the funds they controlled. In spite of the sharp increase in domestic savings, New Delhi remains dependent on foreign capital flows. It would like these to take the form of foreign direct investment (FDI). Portfolio investments were welcome but they had proven in the past to be a very volatile source of external flows. However, to receive FDI in large amounts, potential investors had to be convinced that the Indian economy could expand at the rates that were comparable to those achieved by China and sustained over a long time. Mukherjee, by repeatedly underscoring that a double digit rate of growth was well within India's grasp and that such a rate of expansion could be sustained over time, was speaking to the foreign investor.

Unlike China, India is situated in a neighbourhood where the rates of economic growth are not as spectacular as is the case with the countries that border China. While the Indian economy is set to expand by 8.8 per cent in 2011, having increased by 6.7 per cent in 2010, Pakistan's GDP is estimated to increase at 2.8 per cent in 2010, and 4.2 per cent the year after. Bangladesh's rates of growth for these two years are estimated at 5.7 and 5.9 per cent respectively. India, a high growth economy, in the midst of those growing relatively slowly, faces a different set of challenges than were faced by China as it began to integrate the structure of its economy with that of many of its neighbours. In other words, India's potential as a 'catching up' economy will only materialise when, like China, it begins to work on the integration into its economic structure of the economies of the region in which it is located.

Which Way is the World Going: Towards Turmoil or Settling Down as a New Global Order?

Pessimism is back in fashion, especially about the way the new global economic and political order is likely to shape and how the largest economy in the current system, the US, is likely to perform in the coming years. Recently, several economists, political scientists and historians have begun suggesting that the world is headed towards a major disaster. They worry according to the demands of their discipline and expertise. There are several voices that have been raised if not to speak of impending doom but to suggest extreme caution at the way the future should be viewed. Joseph Stiglitz, the Nobel Prize winning economist who once worked at the World Bank as its chief economist, believes that the Great Recession is not yet over. Growth rates in a number of economies may have turned positive such as China (GDP growth of 8.7 per cent in 2009; and heading towards a double digit increase in 2010), but there are still a number of weaknesses in the global system. He focuses on three of these. 'The US growth rate is too weak to generate enough jobs to absorb those currently unemployed. The rate of the US unemployment is not likely to return to the pre-recession levels for several more years, perhaps not until the middle of the decade. Large amounts of public money spent by a number of countries to stimulate their economies have created debt burdens in economies such as Greece, Portugal, Spain and Ireland. The Central Banks, including the Federal Reserve Bank, are lending at zero rates without conditions.' Stiglitz also believes that the world is inevitably moving towards a new system of reserve currency. 'There is already a forerunner of this in Asia, called the Chiang Mai Initiative (a multilateral regional currency swap arrangement that involves risk-sharing among ASEAN and East Asian countries). If such countries get together and insure each other so that they each have all the money, they could do without the cooperation of the US.'[22]

Niall Ferguson, one of the more important economic historians of our times, has projected a fiscal disaster in the US that will match the one Greece is facing at this time. He says that according to the White House projections, gross public debt will exceed 100 per cent of gross domestic product.[23] That worries him a great deal. He has made his reputation by studying the decline and eventual fall of great empires and nations. Large debt overhang is almost always the cause. That is what brought down the Ottoman Empire in the early part of the 20th century and the British Empire fifty years later. Is America headed the same way? Ferguson believes that is indeed the case. What is causing large fiscal deficits is not only the US government's decision to use public money to revive the economy. The big burden being created by the ageing of the population and the claims of the older citizens on increasing amounts of resources by way of medicare and social security payments are also major contributors.

---

[22] Cheong Suk Wan, "Table talk with Joseph Stiglitz", *The Straits Times* (23 February 2010), p.A19.

[23] This estimate was vigorously challenged by Martin Wolf of the *Financial Times*. According to him "Prof Ferguson is trying to frighten US policymakers out of sustaining or, better still, increasing fiscal stimulus even though the true issue is no longer sustainability." See Martin Wolf, "How to walk the fiscal tightrope that lies before us", *Financial Times* (17 February 2010), p.9.

Some economists see the EU heading towards disintegration with Greece leading the way. Martin Feldstein, who served the Ronald Reagan White House as the Chairman of the Council of Economic Advisers, believes that the only way to save Greece from an economic catastrophe is to let it opt out of the EU on the condition that it comes back with perhaps a 30.0 per cent depreciation in its currency with respect to Euro.[24] But, that may set an unhealthy precedent leading to each weak economy choosing the opt-out route. This is hardly the way to create a US of Europe, which was the dream that led to the creation of a common currency, the Euro, in the first place. In any event, the large EU countries led by Germany are likely to provide financial aid to Athens on the condition that it sets its fiscal house in order. The reaction by Berlin may only postpone the day of reckoning when member states of the EU will finally realise that the monetary union they fashioned and the common currency they created were perhaps premature measures to create a united Europe. There were just too many economic and social differences among the nations of the continent to be united into an economic union with one currency and, therefore, one monetary policy.

There is also concern, especially in Europe, that the US may be turning its back towards the continent and engaging itself more deeply with the Pacific. The Europeans once ecstatic about Barack Obama and what his presidency may mean for the promotion of their cherished principles and the achievement of their goals have become somewhat disillusioned. The American president has put national interest before other interests and concerns. In February 2010, the White House announced that President Obama will not travel to Brussels to attend the summit of the European leaders, an event not missed by previous presidents. Angelo Panebianco, an Italian media contributor, has called the American treatment of Europe 'distracted negligence', the kind of complaint normally made in matrimonial affairs as the attention of one partner drifts in some other direction. According to Jonathan Eyal, a European newspaper analyst, 'the Obama administration has given the impression that it regards Europe as yesterday's story.'[25]

Several political scientists, after having noted with growing concern the increasingly aggressive posture taken by Beijing in early 2010, worried about China becoming the spoiler rather than a leader of the reshaped world. For some time, analysts, including this author, have suggested that the global architecture was being neatly arranged into a pyramid. At the top were the US and China (G2); in the middle, twenty large developed and developing economies (G20); and at the bottom a large number of small nations. Such an arrangement would work if there was reasonable harmony among the nations arranged in the various tiers. This is particularly the case with China and the US. President Barack Obama's November

[24] Martin Feldstein, 'Let Greece take a holiday from the eurozone', *Financial Times* (17 February 2010), p.9.
[25] Jonathan Eyal, 'The sudden big chill across the Atlantic', *The Straits Times* (20 February 2010), p.16A. The Panebianco quote is taken from this article.

2009 visit to Asia seemed to suggest that Beijing and Washington had decided to work together.[26]

However, the optimism generated by the visit was quickly dissipated. Beijing was not prepared to work with the large economies to develop a consensus at Copenhagen on global warming. It has reacted very negatively to the US decision to sell sophisticated arms to Taiwan and the meeting between President Obama and the Dalai Lama. Washington also took note of the dispute between Google and the Chinese authorities siding with the giant American company on its concern with Beijing's attempt to compromise its operations. Both Beijing and Washington got engaged in tit-for-tat actions on trade, using various options available to the members of the World Trade Organization (WTO), to adopt counter-veiling measures when they believe that harm is being done to them by their trading partners.

Rather than moving towards a stronger global economy and a reinvigorated process of globalisation only loosely connected with the larger multilateral structure, the world seems to be developing several split personalities. This is certainly happening in the area of trade and also in the structure of industrial production. The most significant development in the area of trade occurred on 1 January 2010 when the China-ASEAN Free Trade Area (CAFTA) was inaugurated. In the true Asian (or rather the East Asian) fashion, the move towards the creation of one of the largest trading regions in the world was long time in the making. It was first proposed by the then Chinese Prime Minister Zhu Rongji in November 2000. His suggestion was supported by a study that was commissioned to analyse its pros and cons. It was discussed a year later in November 2001 at the summit in Bandar Seri Begawan. The leaders 'endorsed the proposal for a Framework on Economic Cooperation and to establish CAFTA within 10 years'. The process proceeded at a deliberate pace and culminated in its launch on 1 January 2010.[27] The world may thus be moving towards a truncated system – a system made up of regional associations.

Not all analysts are persuaded that Asia is on the verge of becoming an integrated economy. Among them is the London-based magazine *The Economist*, which has always espoused free trade, having been founded by Walter Bagehot, a committed internationalist in trade. While recognising that intra-regional trade has grown in the East Asian region from 32.0 per cent of total trade in 1990 to 42.0 per cent in 2008, *The Economist* wrote that, 'a deeper problem for ASEAN is its cohesion and credibility. It at last has a legal character, but is bound by a strict policy of non-interference that prevents any version of Europe's pooled sovereignty. It began as a cold war security alliance without a common vision. Four decades on, it has as yet to find one. Political, cultural and economic disparities loom large. Even leaving aside the perennial distraction of Myanmar, a repressive military dictatorship that Western allies find hard to sit

---

[26] Shahid Javed Burki, 'President Obama's First Asian Visit', *ISAS Brief 138* (9 November 2009), www.isas.nus.edu.sg/Attachments/PublisherAttachment/ISAS_Brief_138_-_Email_-_President_Obama's_First_Asian_Visit_22022010155310.pdf. Accessed on 31 March 2010.

[27] The history of the process is described in some detail by Rodolfo C. Severino, 'China-Asia FATA: Why the anxiety now?', *The Straits Times* (23 February 2010), p.A18.

down with, mutual mistrust and outright hostility between countries make a mockery of ASEAN's encomiums on unity. They also bode poorly for the resolution of disputes in a closer economic union.'[28]

Adding to some feeling of discomfort about the future is the perennial issue concerning the rise of extremist Islam in several sensitive parts of the world. Those Islamists who are committed to the destruction of the current political and economic order in an attempt to create one more to their liking are spreading out from the borderlands of Afghanistan and Pakistan to such weak states such as Somalia, Sudan and Yemen. The US may succeed in containing these forces in Afghanistan but it is like a balloon that will produce a bulge somewhere else, perhaps in Yemen or Somalia.

There is some truth as well as a great deal of exaggeration in all of this. The global economy is working much better than the pessimists are prepared to grant; the US debt can be handled by increasing the denominator in the debt-to-GDP ratio through sustained economic growth; the tensions in the smaller economies of Europe can be handled through financial assistance and greater market access to the people in the weak states, and China will learn to work as a responsible participant in the new global economic order. There is palpable progress even on the terrorism front. The surge ordered by President Obama in December 2009 in the level of American troops in place in Afghanistan[29] appears to be producing results. On 13 February 2010, the Americans working with the freshly minted Afghan army started an operation in the Helmand province in the country's south. It was billed as the largest effort against the Taliban since the American invasion of Afghanistan in the fall of 2001. Less than two weeks later and without suffering many casualties, the Afghans raised their country's flag in Marjah, a Taliban stronghold. 'With the Afghan soldiers, tribal elders and residents looking on at the flag raising on Thursday [25 February 2010], the governor of Helmand province, which includes Marjah, and a top Afghan army officer promised to restore security and stability to the city of 80,000 near the Pakistani border and to transform it from a "bastion" of the Taliban to a symbol of peace.'[30]

There was also some progress in getting India and Pakistan talking again. Their ongoing 'Composite Dialogue' aimed at resolving some, if not all the problems that had created so much hostility for so long between the two nuclear armed neighbours, was interrupted after a group of terrorists attacked Mumbai in November 2007. Perhaps, urged on by the US, the Foreign Secretaries of the two nations met on 25 February 2010 in New Delhi.[31] Although

---

28 'South-East Asian summitry: Distant dreams', *The Economist* (31 October 2009), p.37.

29 Shahid Javed Burki, 'The United States in Afghanistan: President Obama decides to fight the war his way', ISAS Brief 142 (3 December 2009), www.isas.nus.edu.sg/Attachments/PublisherAttachment/The_United_States_in_Afghanistan_16122009194457.pdf. Accessed on 31 March 2010.

30 "Afghan government's fragile grip in ex-Taliban bastion", *The New York Times* (26 February 2010), p.23.

31 Iftekhar Ahmed Chowdhury has provided an interesting perspective on the talks between India and Pakistan. See, *ISAS Insights 92*, 'Indian and Pakistan: Breaking the Ice (4 March 2010),

not much was accomplished at the meeting, several commentators saw it as positive development. ‘From a wider perspective, there are grounds for some optimism’, wrote *The Straits Times* in an editorial a day after the New Delhi talks. ‘According to one Indian diplomat, Pakistan’s first nuclear test in 1998 paid put to the so-called “foundation myth” which stated that India was opposed to Pakistan’s survival. Both India and Pakistan are committed to stable relations, tensions nothwithstanding… Things are bad, but they could be worse.’[32] At the South Asian Association for Regional Cooperation (SAARC) Summit held in Bhutan in late April 2010, Indian and Pakistan ministers agreed to start peace negotiations between the two countries without preconditions.

There are a number of other positives in the way the global economy is evolving. Also as *The Straits Times* mentioned in an editorial recently, ‘there remains at the heart of the Sino-American relations a super core of mutual interests and as a result of stability. Today, no issue of global import – be it climate change, nuclear proliferation or financial markets – can be solved without the two giants. The blustering rhetoric only belies growing dynamics.’[33] In this context, the newspaper went on to quote Deng Xiaoping approvingly who is reported to have said the following about his country’s relations with the US: ‘When it is good, it won’t get exceedingly good, because of our basic differences when it is bad, it won’t get exceedingly bad, because of our common interests.’[34]

Three things will happen that will produce a world better than the one now. More women will enter the global workforce and expand it. This will contribute to an increase in output. The workforce will be better educated and trained, not just in western universities, but also in the emerging economies. Singapore is an appropriate example of not only good quality of education in the city state but also how well the institutions, faculty and students are integrated with the educational system in all parts of the world. What Singapore has done here is also being done in India, and to some extent, in Pakistan. Finally, notwithstanding the rise of Islamic extremism, there will be a marked decline in militarism. As Gregg Easterbrook points out in his book, *Sonic Boom: Globalization at Mach Speed* [35], a person’s chance of dying in armed conflict is the lowest it has been in human history. In sum, we see the glass three-fourths full rather than half empty.

---

www.isas.nus.edu.sg/Attachments/PublisherAttachment/ISAS_Insights_92_-_India_and_Pakistan_-_Breaking_the_Ice_08032010182935.pdf. Accessed on 31 March 2010.

[32] ‘India-Pakistan talks: Bad, but not too bad’, *The Straits Times: Review & Forum* (27 February 2010), p.A20.

[33] Martin Feldstein, ‘Let Greece take a holiday from the eurozone’, *Financial Times* (17 February 2010), p.9.

[34] ‘Sino-American tensions: Seeing beyond the rhetoric’, *The Straits Times: Review & Forum* (20 February 2010), p.16A.

[35] Gregg Easterbrook, ‘*Sonic Boom: Globalization at Mach Speed’* (New York, Random House, 2009).

Moves Towards a New International Economic and Political Order

How will the shape and structure of the global economy be affected by all the changes that are occurring, some of them at unexpected rates? This paper has focused in particular on the extraordinary rise of China in the latest 'catch-up' period in global economic history. It has also suggested that some of what is being seen now, described as China's second rise, will have enormous implications for the global economy. The question is as to how these changes influence relations among different players in the evolving global economic system. The question has two answers. The system could continue to drift as it is doing at this time. Or, a Bretton Woods type of conclave can be organised to restructure the economic system and move towards a new international economic political order.

If it is the former, we can expect a great deal of destructive competition among the major economic players, particularly between the two major economic powers, the US and China. The US has already lost its position as the predominant economic player in the global system. It can be argued that the world has moved away from unipolarism, when the US was the undisputed leader, towards bipolarism. This can only occur when both sides recognise that they have become the poles of a new system and begin a process of regular dialogue. Such a meeting was agreed to by Presidents Barack Obama and Hu Jintao when they met on the sidelines of the London G20 meeting in April 2009. This was the first multilateral meeting attended by Obama since taking over the US presidency. The possibility of such a meeting was indicated at the inaugural session of the Strategic and Economic Dialogue between Washington and Beijing held in Washington in July 2009. Both sides fielded large delegations at the Washington meeting and the discussions covered several issues of interest to both sides. In his opening address, President Obama said that the US-China relationship will 'shape the 21st century'. With that, he launched the 'G2' without giving it that name.

That the two great economic powers have agreed to establish a framework for regular meetings does not mean that they will able be settle quickly their disagreements and disputes. Can this development create some tension of the type that characterised the 'Cold War' period in which the US and the Soviet Union challenged each other? The conflict between the two great powers then was political, not economic. This was the case even when the struggle between the two was couched in economic terms, Capitalism versus Communism. The US then built a chain of alliances around the Soviet Union and China – this was when it regarded China as an extension of the Soviet Union – while Moscow tried to recruit Cuba and a number of small Central American states as partners. Moscow also encouraged a number of developing countries to remain unaligned. The Non-Aligned Movement (NAM) in which India played the role of a leader had the consequence of limiting the reach of the US. It also shoved India to the fringes of the international political system. It was rescued from that position by the administration of President George W. Bush when it began to work assiduously for a new Indo-US relationship.

However, America and China may not confront each other the way the US and the Soviet Union did during the Cold War. This is for two reasons. They are economically much more dependent on each other than the Soviet Union and the US ever were. China needs the US markets and technology, Washington requires Chinese surplus capital. Also, neither China nor the US has expansionary territorial ambitions. That was not the case with the Soviet Union which was constantly trying to expand its sphere of influence, if necessary by military force. This is what it did when it invaded Afghanistan in 1979. A G2 system, therefore, may prove to be more stable.

Would the second tier powers allow the G2 to rule the waves? It can also be argued that what is being witnessed is the emergence of a multipolar world, going beyond the one dominated solely by the G2. Such a global configuration will reshape not only the global economy but also the international political system. Systems with many poles are inherently less stable compared to those dominated by one or two powers as was the case in the post-Second World War period. There can also be a global system with as many as eight centres of economic activity – the US, China, the EU, Brazil, India, Japan, Russia, Saudi Arabia and South Africa. While the first two may consolidate their strategic dialogue into something permanent, the EU could vie for equality and seek a G3 rather than just a G2 arrangement. For the moment, however, it appears that such an ambition on the part of Europe can only be achieved over the long-term. The EU is still in a formative phase with a considerable dispersal of power among the nation states that are its members. For as long as it does not find a way of working as one entity able to pull is weight in unison, it will not be able to create much of an impression on other parts of the world. Some built-in weaknesses in the way the EU was assembled manifested themselves with the collapse of the economy of Greece in the aftermath of the Great Recession of 2008-09. It appears now that the EU's expansion into a 27-member politico-economy entity could not overcome some of the pronounced differences in the economic characteristics and situation of the states that are its constituent parts. As John Plender wrote for the *Financial Times*, 'much of northern Europe, with Germany in the lead, seems to think that it can continue with its structural surplus and export led growth model while Portugal, Italy, Greece and Spain are throttled. The real return on the savings they plough into southern Europe will probably be negative. Indeed one of the striking historic features of the German balance of payments is how mountainous trade surpluses have delivered mouse-like or negative returns.'[36] The way the growing problems of Southern and Eastern Europe are being handled shows no heed to the wisdom of the American writer H.L. Manken who said that for every problem there is a solution that is neat, plausible and wrong. The EU, it would appear, is not ready for stardom on the global stage.

Japan's relative decline, in particular to the rise of China, was discussed earlier in the paper. Europe and Japan are also two parts of the post-industrial world that are yet to find a way out

---

[36] John Plender, 'Just targeting the symptoms of the crisis is too neat', *Financial Times* (24 February 2010), p.20.

of the demographic cul-de-sac in which they find themselves today. Declining population and aversion to compensate it through immigration will inevitably produce less economic dynamism. Japan also does not seem to have global policymaking ambitions. It seems prepared to play a secondary, perhaps even a tertiary role in influencing how the global economic system works. The same cannot be said of India, which would like to see its growing economic weight reflected in the structure of the global economic and political systems. India is now concentrating a great deal of its effort on accelerating the pace of economic growth. One reason for this is to attract additional foreign capital into the country needed to augment domestic savings so that higher growth can be achieved.[37] The other is to join China in the league of high economic achievers. As James Lamont puts it in the *Financial Times, '*growth of 10 per cent could have a huge transformative impact in a country… it would also take India from out of China's shadow. In what is an increasingly competitive relationship, policymakers in New Delhi like to believe that fast growth and democracy give India the long-term edge.'[38] That notwithstanding, India may not be able to match China's economic success any time soon.[39]

And then there is Russia, a country that has not given up on its ambitions to walk the international stage as a great economic and military power. It has the physical size, natural resources, human skills, and location – proximity to China and West Europe – to someday realise that ambition. But, as institutional economists have begun to point out, large and resource-rich countries do not necessarily become rich unless they have the institutions that can produce the right set of public policies. In this respect, Russia's record has been decidedly mixed. It is still struggling to develop political institutions that would be accepted by all segments of its diverse population. In economic matters, the Russian state has not been able to move much beyond using its large sources of energy for generating resources of development. Consequently, the economy did well when energy prices were high, and poorly when they declined or slumped. The roller-coaster economic record of Russia did not stop it from being invited to become a member of the rich country's club. The G7 became G8 when Russia was invited to attend it in the late 1990s. Given the structure of its economy, it cannot strictly be described as an industrial country.[40]

The remaining poles may try and create their own spheres of influence. But, their reach will be inherently limited. These economic centres could, if circumstances permit, create their own spheres with a greater prospect of clashes than it is likely in a bipolar world. These

[37] Shahid Javed Burki, 'China and India: Is Policymaking by the Two Giants Merging?', *ISAS Insights 95* (19 March 2010), www.isas.nus.edu.sg/Attachments/PublisherAttachment/ISAS_Insights_95_-_Email_-_Are_the_Two_Asian_Giants_Merging_19032010181714.pdf. Accessed on 31 March 2010.

[38] James Lamont, 'Why 10 is the magic number in New Delhi's race with Beijing', *Financial Times* (8 March 2010), p.2.

[39] See, Shankar Acharya, 'Rising India labors in the shadow of Asia's real giant', *Financial Times* (29 July 2009, p.7.

[40] That the size of the Soviet Union's economy and its rate of GDP growth were highly exaggerated not deliberately but because of the indices the statisticians employed, was pointed out by the economic historian Alexander Gerschenkron in the late fifties.

clashes will occur in the areas where the different spheres come into contact. The most likely places where clashes may occur are in Central and South Asia and the Middle East. Not only will these result from competition for geographic space, which was the reason in the past for clashes between centres of power, there will, in addition, be economic reasons for conflict. In a global system increasingly short of scarce resources vital for sustaining development, there will be immense competition for energy and water, and possibly also for minerals vital for development.

Another scenario is also possible. It combines to some extent the first two. If the US and China become the two dominant powers, the global system could have three and not two tiers – the two global powers, four or five regional powers and the rest. In this case, the two large powers will seek to circumscribe each other by creating economic and political alliances close to the other power through attempts to recruit the secondary powers to their side. The current thinking in the US emanating from a number of policy institutions sees the coming global arrangement from the bipolar perspective, in part because such a system is familiar to the policymakers as well as policy analysts. However, this does not mean that the policymakers will necessarily eschew conflict in favour of cooperation. For instance, the administration of President George W. Bush saw China as a competitor having proclaimed openly in the strategy document issued by the White House in the summer of 2002 that the US will not tolerate any competition to the position it held and will do all it needs to do to preserve its status. It was in part because of this that the Bush Administration paid so much attention to cultivating a new relationship with India. Developing India as a counter-weight to China served to further America's interests in Asia. President Obama, on the other hand, has been ready to accept a lower profile for the US in the evolving global system. That was the theme of his first official visit to Asia in November 2009.[41] If this view prevails, the global system will probably be structured into three tiers – the G2, the G20[42] and the rest.

It is possible to contemplate a three-tiered system of governance for the global economy. That this may happen has led to some talk about G7 or G8 being replaced by the G2. This would mean slowing the move towards the creation of a multilateral system that receives direction from a much broader grouping than G7 or G8. In this context, the role played by G20 was seen to expand. This group includes, in addition to G8, 12 largest emerging economies from all parts of the world. It has met twice since November 2008. Since the first meeting, the group has met in London in April 2009 and in Pittsburgh in the fall of the same year. At the London meeting, Prime Minister Gordon Brown, the meeting's official host formally buried *The Washington Consensus*, declaring that the state will always have a major role to play in economic management. At the Pittsburgh meeting, the host President Obama

[41] Shahid Javed Burki, 'President Barack Obama in Asia – Searching the basis of a partnership', *ISAS Working Paper 102* (7 December 2009), www.isas.nus.edu.sg/Attachments/PublisherAttachment/President_Barack_Obama_in_Asia_-_Searching_the_Basis_for_a_Partnership_18122009175737.pdf. Accessed on 31 March 2010.

[42] It should be pointed out that the G20 as currently constituted also includes the United States and China.

attempted to get the assembled leaders to develop common ground for meeting the challenge posed by global warming.

The main task before these two meetings was to come up with a new structure for managing the global economy. This would have led to the development of a new form of multilateralism. This did not occur and may not happen for the simple reason that G20 was being built on top of a system that had creaky foundations. The focus remained on the US and Western Europe. The latter, in particular and for the reasons mentioned above, is no longer the most vibrant part of the global economy. There may not, after all, be such a widening of influence and reshaping of the global economy as was believed earlier in 2009. G2 may emerge as the most important player in the new system. The slow move towards multipolarism may be pre-empted by the continuing strength of the economy of the US and the 'second rise of China'.

The future of the global system could thus be framed by the outcome of competition among several operators, each trying to maximise its own space within the system. This is a recipe for confusion and chaos. It was in anticipation of something like that happening that the victors of the Second World War went to Bretton Woods in New Hampshire to craft a new international economic order. While the system they evolved allowed participation to smaller countries, it was dominated by those who were heavily involved in beating back the challenge from Nazi Germany and Imperial Japan. Even when Germany and Japan had recovered and were admitted into the system, power remained in the hands of the victors, in particular the US. But the world has changed remarkably in the last one or two decades. The scale of change has been accelerated by the Great Recession of 2008-09. Perhaps, the best way to construct a new order is to convene a Bretton Woods II.

There cannot be any doubt that the new system, no matter which way its gets built and structured, will look very different from the one that has dominated the global economy and the one it will replace. As Martin Jacques writes in the concluding pages of his book, *When China Rules the World*, 'the rise of competing modernities heralds a quite new world in which no hemisphere and no country will have the same kind of prestige, legitimacy or overwhelming force that the West has enjoyed over the last two centuries. Instead, different countries and cultures will compete for legitimacy and influence. The Western world is over; the new world, at least for the next century, will not be Chinese in the way that the previous one was Western. We are entering a world of competing modernity, albeit in one in which China will increasingly be in the ascendant and eventually dominant.'[43]

[43] Martin Jacques, '*When China Rules the World: The Rise of the Middle Kingdom and the End of the Western World'* (London, Allen Lane, 2009), p.433.

Conclusion

This paper by picking up on the theme developed by several economic historians – that the order among countries never remains unchanged as some of those that have fallen momentarily behind 'catch-up' with those in the lead and this reconfiguration is often accompanied by great conflict – suggests that the world is again passing through a period of 'catch-up'. This period differs from those in the past in many ways. Of these differences, three need to be noted. China is the country that is doing the most 'catching up' in the first couple of decades of the present century. Unlike the previous cases, it is structurally very different from the country that is currently in the lead, the US. Even if China overtakes the US in PPP accounting, it will remain a poor country. Income per head of the population will still remain a fraction of that of the US. This means that the composition of demand as well as the commodity composition of its national output will be very different from those of the rich countries. China will become a very large consumer of energy and other inputs needed by a relatively underdeveloped economy and this can only be possible if the world's rich countries curb some of their own consumption. This is already happening to the extent not fully recognised by those who worry about climate change. As Alan Greenspan once said (a few things about which he was right) that the Western economy was becoming lighter, consuming fewer physical resources than earlier. Knowledge is a far more important component of incremental output in the West than in emerging countries. Knowledge, of course, is weightless. Technological changes will also lighten the product in China and other parts of the developing world.

China's rise, and relative declines of Europe, Japan and the US, will not produce the type of conflict that marked the 20th century, by far the bloodiest in human history. The rearrangement of the chairs on the deck will happen without much turbulence. Europe and Japan have chosen to proceed along lower growth trajectories in order to not have their cultures diluted by the presence of large foreign workforces. The speed with which their populations are ageing means that unless they allow more immigration, they cannot continue to grow at historical rates (if history implies the rates of growth of the second half of the 20th century). Long-term growth rates depend on supply factors, not just demand. An economy's long term 'potential' or 'trend' rate of growth – the rate at which GDP can increase – is determined by growth in its labour supply and productivity. Europe and Japan are running out of workers; the pending decline in the size of the workforce cannot be compensated by productivity increase. Even for productivity increases, economies need educational and research institutions. But, they can only remain dynamic if the proportion of the young in the population is reasonably high. Among the current developed countries, it is only the US that continues to see an increase in the size of its population, both through migration and a rate of fertility that is higher than the replacement rate.

The US will continue to be the economy with the most clout in the global economic system even if it loses the first place to China which is not likely to happen anytime soon.

Productivity increase will play an important part in the US and because of its strong educational and technological bases; it is likely to keep it high for many decades to come. Productivity will also increase in emerging markets, in China in particular, because of the massive infrastructural investment in these countries as they seek to stimulate their economies to escape the impact of the Great Recession of 2008-09. It will also propel the South Asian economies towards higher rates of growth.

For the last several decades the developing world has had a much higher rate of GDP growth than the developed world. This is particularly the case for the emerging markets of Asia. For the next few years, the entire increase in global output will come from emerging economies. It is for this reason that analysts such as Fareed Zakaria, Thomas Friedman, Kishore Mahbubani and Martin Jacques, have suggested that the centre of gravity of the global economy is shifting from the Atlantic to the Pacific. The emerging world's remarkable performance has been led by its two largest economies, China and India. But this change, even when it occurs rapidly as in the closing years of the first decade of the 21st century will not produce global conflict. The strong linkages among the economies of the world's large countries mean that the global conflagrations of the type that convulsed the 20th century may not be seen in the 21st. Asia will 'catch-up' with Europe, Japan and North America without an upheaval. The 21st century will not only be the Asian century but it will also be a century of relative peace.

In other words, a significant reordering of the global economic and political structures will occur in the next few decades – possibly in the next few years – in which Asia, having 'caught up' with the US, Japan and Western Europe, will play a prominent role.

oooOOOooo