Ensuring China's High Growth: Coping with the Fast-Changing International Environment

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GDP in trillions of 2005$

(BRIC = Brazil, Russia, India and China)

	G-7	BRIC	USA	China	India
2005	27.3	4.2	12.5	1.9	0.7
2025	39.3	20.4	19.6	11.7	3.6
2040	52.3	52.3	29.2	29.4	12.9
2050	64.0	90.0	37.7	48.6	27.2

In 2040, BRIC equals G-7, and China equals USA. In 2050, India equals G-6 (G7 excl. USA)

Painful Experiences with Recent Entrants on to World Stage?

- Pessimism from rise of Germany, Japan and Soviet Union in early 20th Century
- Optimism cannot be ruled out however. US was most important power to emerge in 20th Century
- China's rise differs from US rise in 2 ways
  - World stage more crowded, more players means higher organisational costs, and greater diversity, making cooperation harder. Need to expand stage size.
  - Not addition of one giant but of two giants: China and India. Need to strengthen the structure that supports the stage.

Why Rise of China Might be Delayed

- Hardware failure (in economic mechanism)
  - weak state bank system drains fiscal capacity with repeated recapitalizations
  - continued large state sector saps overall dynamism
- Software failure (in institutions of governance)
  - growing inequality is attributed to original sin in capital accumulation rather to than Kuznets Curve
  - rising social expectations clashes with an inadequately responsive state
- Power supply failure (from an external limit)
  - looming water shortage China (and in India)
  - protectionism & sanctions

The focus of this talk will be on Power Supply Failure, which will most likely have external origins, and hence will require actions at the international and regional level.

An Unnatural International Division of Labor in 1990 caused by self-isolation

Employment	Global	Advanced	LDC	New
(in millions, before and after ending self-isolation)				
1990 Before	1,083	403	680	---
1990 After	2,315	403	680	1,232*
2000 Before	1,289	438	851	---
2000 After	2,672	438	851	1,383#

* China, 687; India, 332; Ex-Soviet bloc, 213

China, 764; India, 405; Ex-Soviet bloc, 214

Source: Richard Freeman, "Doubling the Global Work Force: The Challenge of Integrating China, India, and the Former Soviet Bloc into the World Economy," November 8, 2004. (*Global total here are different from the original Freeman source*)

Economics and Politics of New International Division of Labor

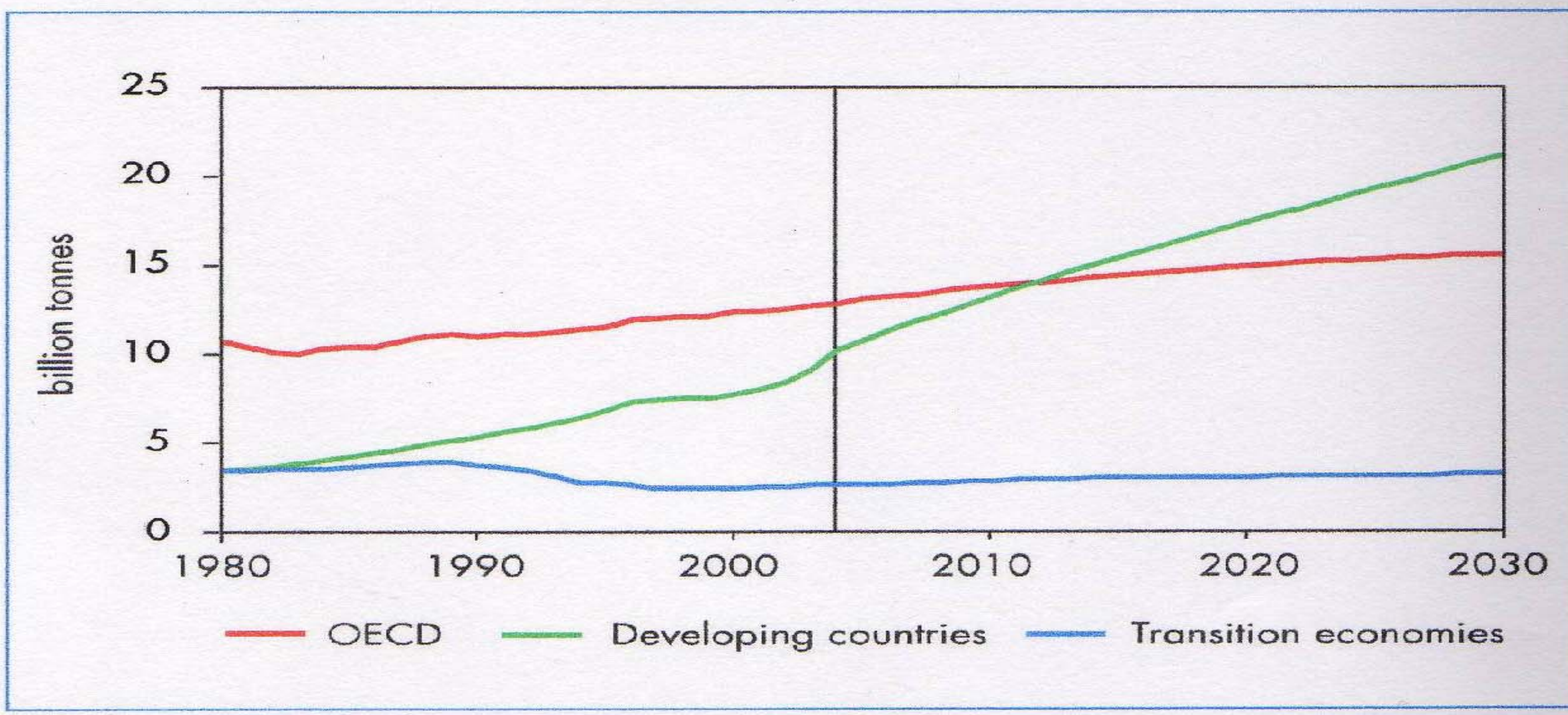
- Economics: Adam Smith The Wealth of Nations (1776): "Greater wealth with greater division of labor; and the larger the market, the greater the division of "
- Politics: Jeffrey Frieden Global Capitalism (2006): "Rise of democracy and of social expectations make free-market-style structural adjustment very difficult."
- Standard theory says post-globalisation equilibrium has higher national welfare level. However, the movement to the new equilibrium could involve a period where welfare is below original equilibrium for some countries. Minimize pain with protection?

Atmosphere is Ripe for Protectionism

- Size of adjustment: 100 pct labor market shock
- Speed of adjustment: fast movement up value-added chain
- Globalization coincides with technological changes that (a) worsen income distribution and (b) broaden impact of trade on service sector
- Decline in US political tolerance toward trade adjustment in post-Cold War
- Unraveling of intellectual consensus in USA? Paul Samuelson’s & Alan Blinder's apostasy
- Post-September 11 syndrome: insecure people don’t make the best decisions, KORUS FTA

Atmosphere is also Ripe for a Coming Clash over the Global Commons?

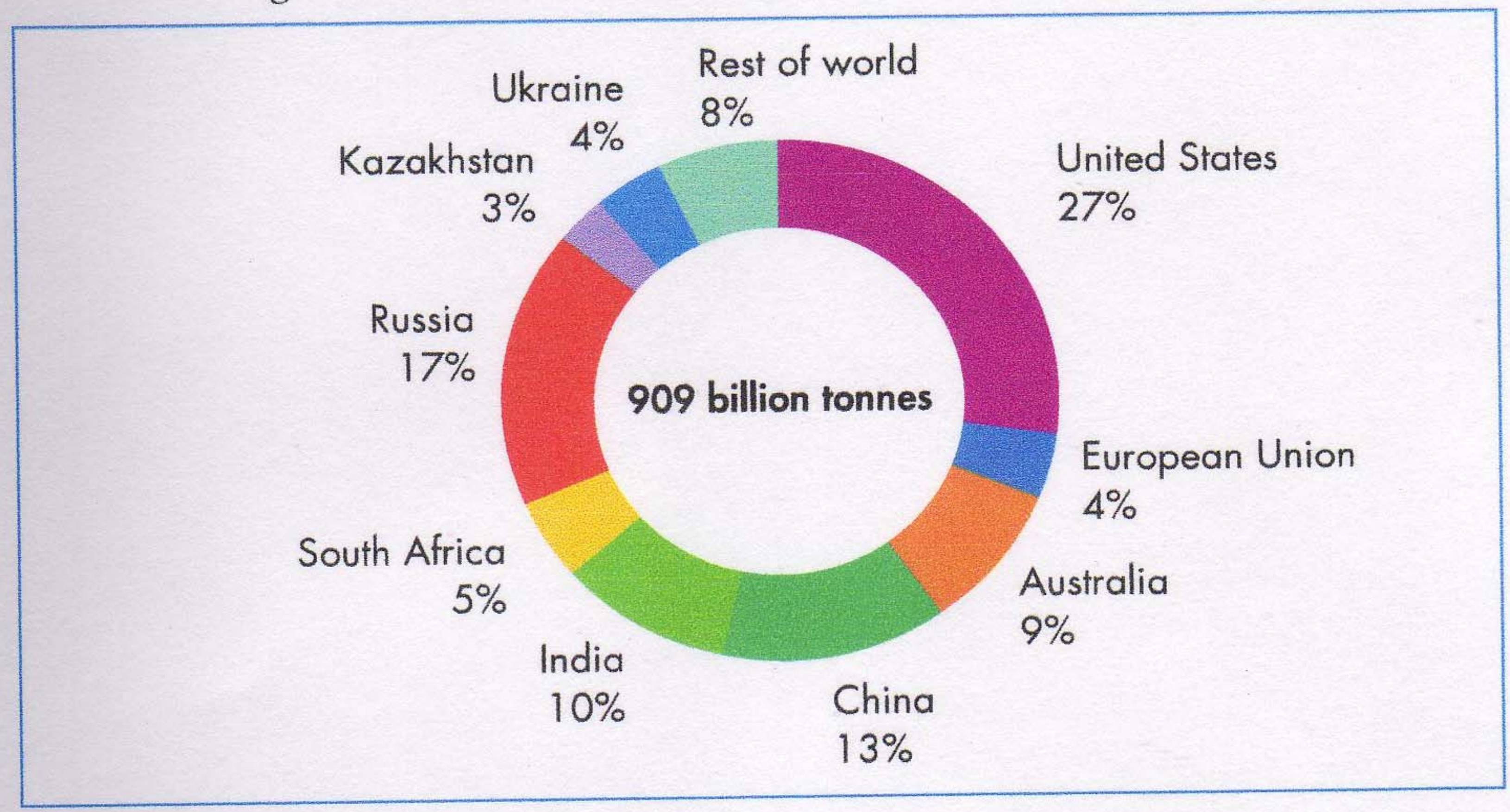
Figure 2.9: **Energy-Related CO_2 Emissions by Region in the Reference Scenario**



Note: Excludes emissions from international marine bunkers.

China and India have incentive to use their ample coal reserves

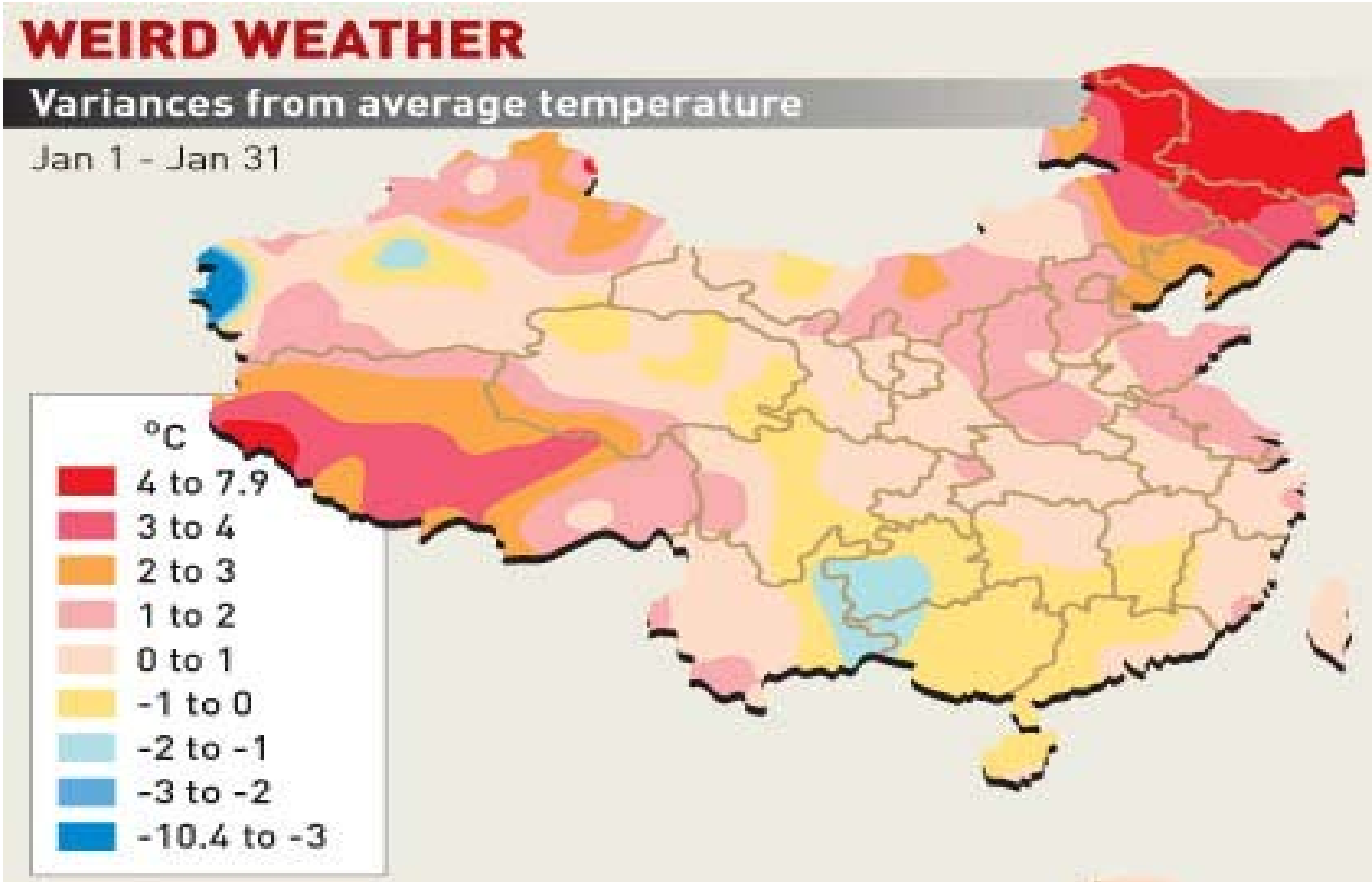
Figure 5.2: **Proven Coal Reserves by Country** (end-2005)



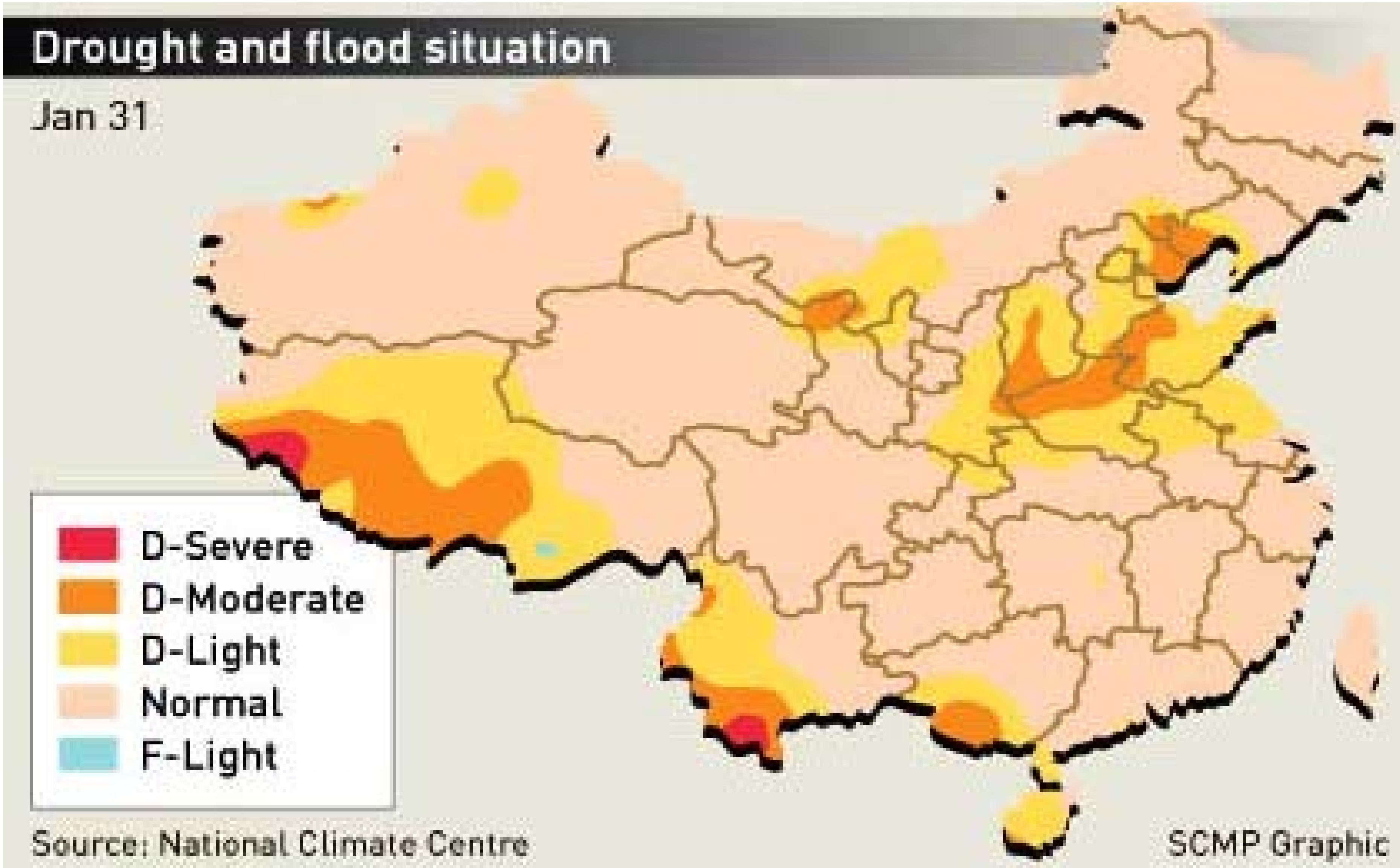
Source: BP (2006).

The Global Environmental Commons: International Wrangle not just over Air but also over Water as well

China: Climate Change

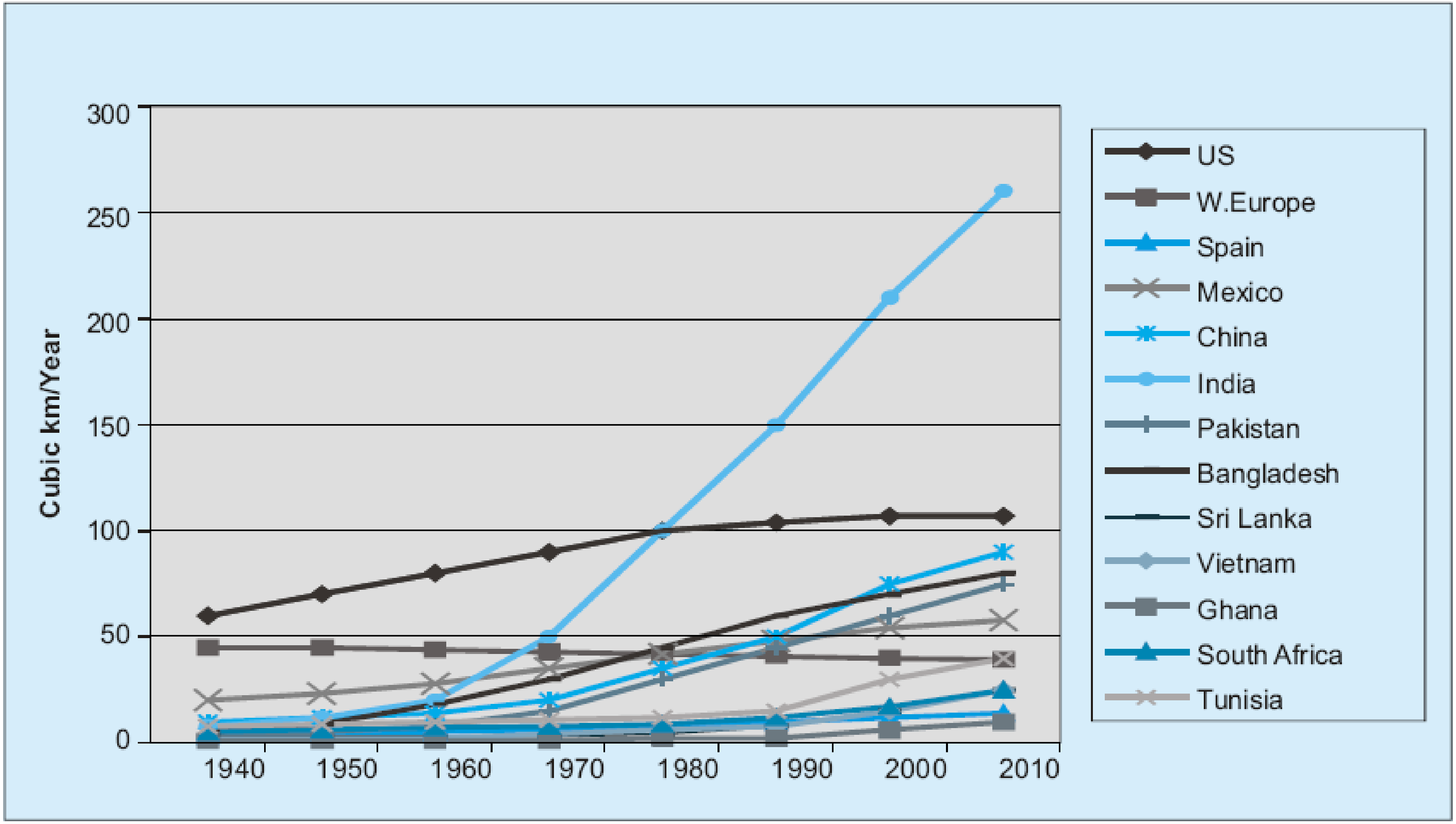


China: Change in Rainfall Pattern



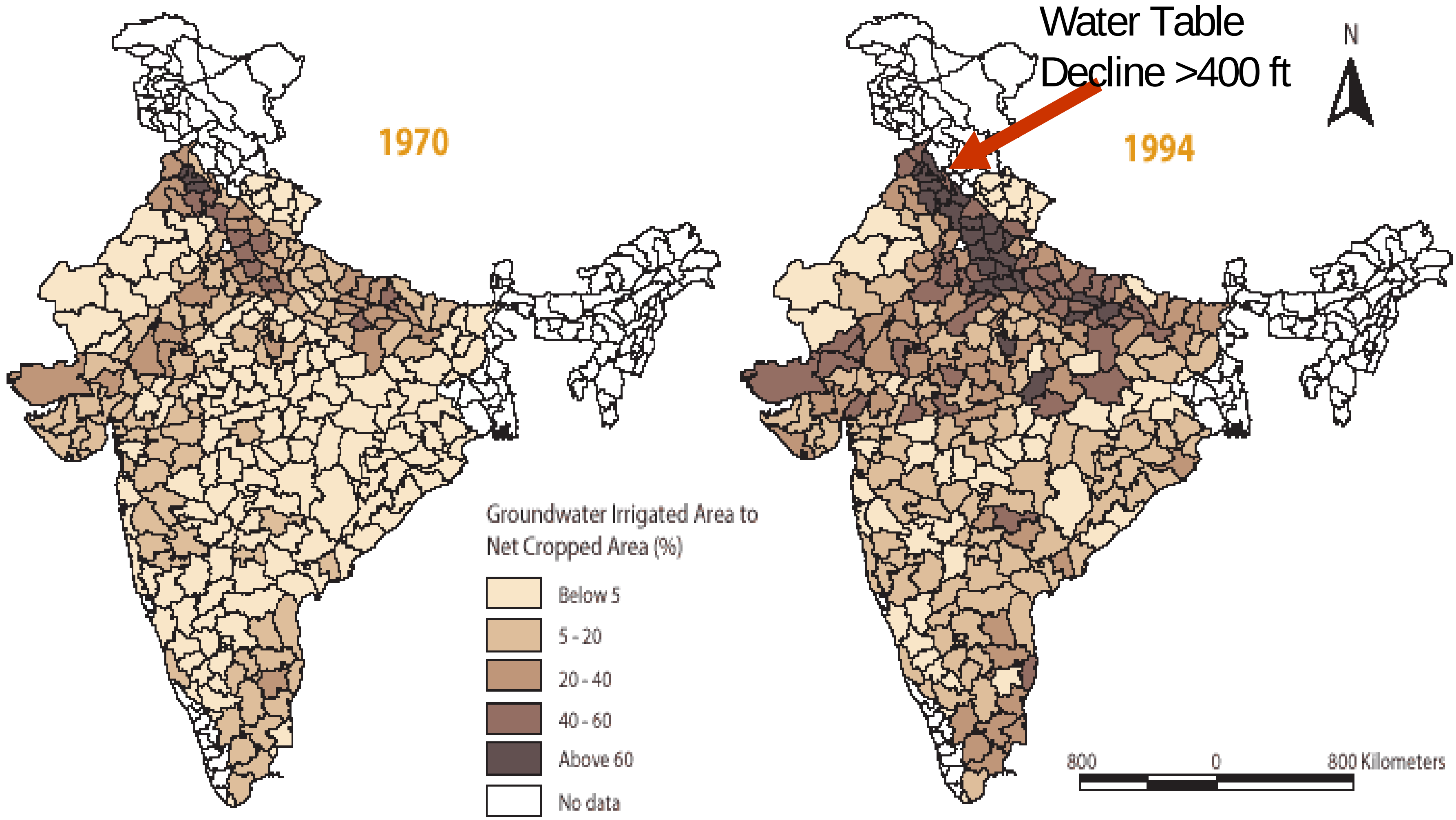
Looming Water Crisis in Asia

Figure 1: Growth in Groundwater Use in Selected Countries



Source : Author's estimates

India: Exhaustion of Aquifers



District-level population density of India, overlaid with the numbers of groundwater structures fitted with mechanized pumps within those districts. Each dot represents 5,000 energized pumps. The density of energized wells and tube wells corresponds with population density.

Asian economic integration

“Involuntary” tight integration as response to protectionism outside of Asia (e.g. failure of Doha Round)

- ***Passive***: Asian integration as result from the effective end of WTO multilateralism
- ***Pro-active***: Integration as a bargaining chip to preserve WTO multilateralism
- **Integration to be starting blocks for global integration. FTA expands from ASEAN+3 to ASEAN+6 to APEC to ...**

Forms of Integration

	EU	NAFTA	Proposed Asian Integration
Free trade	yes	yes	yes
Free capital movement	yes	yes	yes
Free labor movement	yes	limited	very limited
Common currency	yes	no	in (far?) future; immediate exchange rate coordination proposed
Political union	yes	no	no

Why European Economic Integration?

- Especially initially, strengthen ties within NATO coalition
- Subsequently, restrain the scope for unilateral actions by growing West Germany and then of united Germany
- Enabling factors
  - Biggest countries wish to integrate
  - Common political system (democracy) and cultural heritage (Ukraine preferred to Turkey)
  - Similar economic structure – low adjustment costs

The Asian Situation

- Divisive factors
  - Historical factors e.g. Yasukuni
  - Different international camps (Japan and ROK are US security partners)
  - Dissimilar economic structure – higher adjustment costs
- Cohesive factors
  - Establishment of EU and NAFTA
  - Experience of Asian financial crisis
  - Explosive growth of fragmentation trade
- Fundamentally, only the world market is big market enough for China and Japan
  - Regional integration as starting block, not stumbling block, for global integration?

ASEAN+3 to ASEAN+6

- East Asia focus broadened to include Australia, New Zealand and India in December 2005.
- Expansion balances China with India, and with Japan-ANZAC alliance (Japan-Australia security pact signed March 2007.)
- Inclusion of India is good economics (bigger the grouping, the larger the benefits), and good politics (avoids built-in confrontation between China and Japan-ANZAC alliance).
- Greater diversity means longer period to achieve deep integration, but avoidance of conflict makes outcome more certain.

Should there be a common currency in Asian economic integration?

NAFTA GDP: US dominates now and in future

2005$ trillion	USA	Canada	Mexico	Brazil
2005	12.5	1.2	0.7	0.7
2025	19.6	1.8	2.4	2.3
2050	37.7	3.0	7.8	8.0

- Survival of individual currencies

EU GDP: Fairly equal size

2005$ trillion	France	Germany	UK	Italy
2005	2.3	3.1	2.3	1.9
2025	3.2	3.9	3.3	2.5
2050	4.9	5.4	5.1	3.1

- Common currency as compromise among equals, especially needed in a political union to prevent any more French-German wars

Asia GDP: Japan now, China in future

2005$ trillion	China	Korea	Japan	Indonesia	India
2005	1.9	0.8	5.3	0.3	0.7
2025	11.7	2.6	6.7	1.0	3.7
2050	48.6	3.7	8.0	3.9	27.2

- Yen block now and Yuan block in future?
- If NAFTA outcome, then present push for Asian Currency Unit is wasted effort and detracts from deep trade integration. Establishment of a regional financial center that matches London and NY is the appropriate form of financial cooperation.

Different drivers for economic integration produce different forms of economic integration

- European Union – a politically-driven process powered by German money and French ideas to prevent future wars. A political union requires a common currency.
- Asia – a market-driven process powered by Japanese technological capacity and Chinese manufacturing capacity to harness division of labor, with Australia and India to balance China. No political union, hence no common currency, needed.

From the Asian Challenge to the Asian Opportunity -- the best is yet to be if:

- the crowded world stage is enlarged and the support of the stage is strengthened
  - Effective domestic trade adjustment programs
  - International compliance of WTO clauses
  - International agreements on management of global commons
- technological innovations occur to lower environmental costs, e.g. clean burning of coal. Technological breakthroughs not a pipe dream because problem-solving power of the world will increase significantly with the education of the Chinese and Indian population.