

Asia: The New Global Economic Powerhouse

Asia is fast developing into the global economic powerhouse. Despite various difficulties and environmental problems which may pose policy challenges in the future, it is likely that Asia's assets such as global savings, stronger competitiveness, multinational companies and future Asian integration will further continued high growth.

The US economy

Until recently, the US was the decisive factor in the global economy – the trendsetter or the pacesetter. The rest of the world followed the American business cycle with a time-lag. That is no longer the case. When discussing Asia, the starting point must therefore be a short analysis of why and how the American economy has lost this position. Even if it may look a bit out of context to compare the US and Europe, it reveals the weaknesses of the US economy opening the door or rather inviting Asia to take over.

The US economy is generally perceived as much stronger than the European one, indeed the pacesetter for the global economy. This perception is wrong.

In an article published November 19, 2005, *The Economist*¹ punctures some of the myths and comes to the conclusion that the decisive factor behind the stronger US economic performance compared to the European one is “that America's population is increasing much faster than the euro zone's”.

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The Nobel laureate Robert Mundell comes to the same basic conclusion – that the main difference between the US and Europe is population growth. In an interview in September 2006, he says “[s]ome say that Europe has performed badly compared with the US over the past

10 years, but they forget that Europe has zero population growth and that European per capita income isn't much below the US figure.”²

The high US growth rate of approximately 3.5% per year over the last five years cannot be counted upon to continue, even if we put the sub prime crisis aside for a while. A lower trend growth is in the cards, as the proportion of the US population available for work will not continue to rise – on the contrary, it is falling.³

US consumption has pulled the rest of the world along, but rested upon debt with property as collateral. This was fine, indeed splendid, as long as property prices continued to go up, but as we now know and was predicted by a number of people the property bubble would burst. Former FED chairman Alan Greenspan has calculated that approx 3% of personal consumption expenditure rests on this particular kind of borrowing.⁴

There is no reason to elaborate on the sub prime crisis apart from stating that this is a mess bringing home to roost all the birds let loose by an irresponsible loan policy by a long list of US financial institutions, almost representing a who is who in global finance.

The point in this context is that the calamities in the slipstream of the sub prime crisis will not be a short-term matter, but a long drawn out affair putting a ceiling on US growth for a number of years. The argument behind this statement is that – as shown in a paper by Edward E. Leamer of the UCLA – housing is not a price cycle, but a volume cycle.⁵

This explains why:

- We cannot count upon the US economy as the pacesetter any longer and if we could it would point downwards.
- It will take a while before we see economic growth in the US much above 1.5-2% on an annual basis.
- Much effort in the coming years will be devoted to redress economic imbalances accumulated in the US over the last decade or so.

These three elements tell us how important it is to look at the strength of the Asian economies, as neither Europe nor Japan will be able to step in and fill the vacuum created by the US. Either Asia makes it as the pull factor in global growth or no one does.

US imbalances, economic policy and the role of Asia

The US economic imbalances need to be redressed and they will be. The question is how and when. The well-known economic theory about adjustment of imbalances on the balance of payments tells us which instruments are available, but politics determine the mix to be applied.

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It is all about transfer of purchasing power from the US to Asia. In other words the US Gross Domestic Product (GDP) per head must go down (at least relatively compared to Asia) and the GDP per head in Asia must increase.

US fiscal policy might be mobilized, but few will expect the Bush administration to increase taxes. The room of maneuver to reduce spending is almost nonexistent after a number of years with cuts, except for the military sector which is not likely to suffer cuts. The most effective instrument thus does not look suitable in light of the political situation.

Monetary policy could also do part of the job, but the misguided policies of former FED Chairman Alan Greenspan – waiting too long to push the interest rates up – has left the FED with almost no options and if it had any the sub prime crisis has taken them away. Now

it is a foregone conclusion that rates will be lowered to stimulate the US economy, ruling it out of the game to transfer purchasing power from the US to Asia. That leaves three options, each of them not very attractive.

Almost all price-sensitive production has been outsourced to Asia.

First, the currency rate through a depreciation of the US Dollar: That will certainly take place, actually it has already has, but more vis-à-vis Europe than vis-à-vis the Asian currencies. In the summer of 2000, the US Dollar-Euro rate was close to 82 US Dollars per 100 Euro, in the beginning of 2008, it is close to 160. This translates into a depreciation of the US Dollar vis-à-vis the Euro of more than 50%, and still the US balance of payments has not improved. The depreciation vis-à-vis the Asian currencies is less, as Asia has chosen to be a Dollar zone.

The problem, as the US-Euro development shows, is that currency rate changes do no longer hold the same sway over the balance of trade. The reason for this has something to do with Asia. Almost all price-sensitive production has been outsourced to Asia. Production left in Europe or the US competes on other parameters than prices and costs. How relevant is a depreciation of say 10 or 20% if the unit costs in China are between 5 and 10% of costs in Europe or the US?

Second, semi-protectionism or even worse a swing towards outright protectionism: This is, unfortunately much more relevant. The shifting trend is more visible in the US than in Europe. Clearly the mood is changing. The seminal change in the US attitude towards the rest of the world since 9/11 – shifting from openness to seclusion – has cast the rest of the world in the image of an enemy, may be not militarily, but rather psychologically and economically.

The ongoing campaign to win the nomination for the Presidential race has legitimized attacks and accusation on other countries and 'America first' is commonly used by the candidates. Even Republicans display fewer ardors than usual in defending free trade and among democrats free trade is game for everybody to shoot at. One of the leading candidates [at the time of writing], Senator Hillary Clinton, stated in an article in the Fi-

nancial Times that “she believed that theories underpinning free trade might no longer hold true in the era of globalization”.⁶ Later in the same article, she spoke about America’s “economic sovereignty”. In February 2006, a number of Senators from both parties confronted a Dubai-based consortium’s purchase of US harbors and announced the intention to introduce legislation to prohibit companies owned or controlled by foreign governments from running port operations in the United States.⁷

Third (and probably the most likely outcome), a worn out and tired US might not manage to find the time and resources to tackle the problem, leaving it to market forces. If so, a correction will certainly take place, but under circumstances, which may be very unfavorable, dominated by abrupt and violent swings in economic fundamentals.

Asia confronted with rebalancing of the US economy

Two factors determine whether a regional economy has moved into self-sustaining growth:

- a supply chain (trade with semi-manufactured goods finally transformed into the end product) linking the countries together in supporting each other and being more dependent on each other than on other regions in the world.
- the strength of domestic demand and private consumption emerging as the main driver behind the regional supply chains, that is countries export to each other to prop up domestic demand instead of consumption in non-regional countries.

Europe has some time ago moved into the stage of a self-sustaining economy with a declining dependence on the US. Economic statistics show that exports to the United States account for less than 3 percent of the euro zone economy.⁸ Private consumption gobbles up between 50 and 60% of total Gross Domestic Product depending upon the business cycle.

Over the last decade or so, China’s share of US imports has risen strongly, while most other Asian countries’ shares have gone down. An analysis of export figures from 1996 to 2003 shows that China’s share of the US market has gone up from 8.5 to 22.4%, while most other

Asian countries’ shares have been reduced to approximately one third of their size in 1996.⁹ This points to the observation that the share of exports from Asia to the US has not changed visibly, but that China has emerged as the end-producer. It imports semi-finished products from the rest of Asia to export the final product to the US. If this were still the case, Asia would not be a self-sustaining economy.¹⁰

What has recently happened, however, is that when China’s exports go up with 1%, imports to China from other Asian countries go up with 1.3% for semi-manufactured goods and 2.8% for investment goods.¹¹ Goldman Sachs has calculated that in 2007 only approximately 1.6 percentage points of Chinese growth (estimated at 10%) came from exports to the US compared with 2.7 points in 2005.¹² Deutsche Bank figures that a 1 percentage point slowdown in the US would trim China’s export growth by 4 percentage points and reduce Chinese GDP by 0.5 percentage points.¹³

In a macroeconomic context, China is the dominating economy in Asia and the figures mentioned above indicate that Asia (or at least East Asia) is turning onto the path towards a more self-sustaining economy.

If we add the observation that intra-trade in East Asia amounts to approximately 54% compared with approximately 64% for the EU and approximately 46% for NAFTA, the conclusion becomes quite different.¹⁴ It looks like a supply chain is building up geared more to Asia’s own needs than exports to the US. The preliminary growth figures for Asia in the third and fourth quarters of 2007 connote that the slow-down in the US economy had some, but no major impact on growth in most Asian countries. Growth forecasts for 2008 published by the World Bank in the beginning of January 2008 support this view.¹⁵

Figures published by the Asian Development Bank reveal that in the five year period from 2001 to 2005 Chinese growth was steered by investment, with a little more than five percentage points followed by private consumption with a little less than three percentage points, while government consumption and net exports had no significant impact (The impact of net exports was even negative in two of the five years, 2001 and

2002, and negligible in 2004.).¹⁶ Taken together, private consumption and private investments account for approximately 90% of total Chinese GDP.

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Various analyses of private consumption in China warrant this statement. Two elements are of particular importance: trendsetters and mass consumption.

Global cities emerge as a possible determining parameter for future trendsetters with regard to taste, style, preferences, brains and the likes, telling us where the strongly rising revenues and profits are to be found.

China is today the world's third largest luxury goods consumer and prognosis tells us that by 2015 it will be the number one worldwide.

Almost all the new global cities or hubs will be found in Asia. Suffice to mention Shanghai, Beijing, Mumbai, Guangzhou-Hong Kong, maybe Singapore-Johore, maybe Saigon and in a long-term perspective cities like Chengdu, Chongqing, Bangkok and Sydney. A few months ago, the theory about the spiky world – setting this out with utmost clarity – was published by Richard Florida.¹⁸ The global elite asks for a common environment with regard to taste and preferences making its members at ease and at home and it will not be confined to one geographical place. It will move around the globe and choose geographical places with a congruous stylistic environment. Wealth is gradually transferred from the US and Europe to East Asia, which tells us that the future global elite will strike roots in Asia and consequently new consumption patterns emerge there. This also means that companies shooting for this extremely lucrative segment of the market will either be born in Asia or be Western companies having felt where the wind is blowing and migrated from Europe and the US to China, India and the other economic power centers (migrated in the sense that the 'brain' of the company has moved from former headquarters to be in touch with new tastes).¹⁹

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holds in the income bracket driving demand for luxury goods will rise in the Asia/Pacific region from approximately 100 mio. in 2006 to almost 250 mio. in 2016 with China as the main source, opening up for a purchasing power of almost 260 billion US Dollars in 2016 after an annual 12% rise from 2006.²¹ A similar trend is emerging in India with a growing middle class and a growing number of people moving into the segment of luxury goods.

In 2004, China's consumer market was number seven on the global hit list and Credit Suisse First Boston has calculated that in 2014 China will be the number one market with an annual growth in consumption of 18%.²² The prognosis points to a share of Chinese urban households with an income of 5,000 US Dollars will rise from 17.4% in 2004 to 90% based upon an annual growth rate of 24%.²³

The main drivers behind the rise of Asia

Supported by the strong and buoyant domestic economy, Asia is moving fast to overtake the US (and Europe) as the pull factor in the global economy. Five elements illustrate this and expose how Asia is gradually controlling the global economy.

1) Skill content of exports

Economists have long looked for signs of Asian exports moving into high value. That would signal a much more mature status for the Asian economies and would again cement the belief that Asia is becoming a self-sustaining growth area.

The International Monetary Fund has analyzed Chinese exports from 1992 to 2005 to find out whether they have more skill content or are still kept in the traditional mould.²⁴ The findings are that measured in per cent of manufacturing export the following sectors have fallen in their share: textiles, apparel, footwear and miscellaneous manufacturing.

The following sectors, however, have increased their share: industrial machinery, office machines, telecommunications and electronic machinery. That leaves little doubt that China is changing track from cheap labor to skills-based exports. The question remains, however, how much that is due to China's own performance or China, as mentioned earlier, is the end link in the supply chain, thus merely reflecting imports with

higher skill content which are assembled for re-export. The study concludes that by excluding skills from imports the figure is much less visible, thus indicating that imports with higher skill content account for a considerable part. However, as these imports primarily come from other Asian countries, it may tell us that China is slowly moving towards higher skill exports, while Asia as such is moving faster.

The latest figures for 2007 tell us that China's high-tech exports in the first three quarters rose with 24.7% to 244 bn. US Dollars accounting for 27.8% of total exports. The figures for imports show a similar picture with a total value of 208 bn. US Dollars after a hike of 16.7% accounting for 30.1% of total imports.²⁵

2) *Economic integration*

So far, the Asian market has largely been fragmented in the absence of genuine economic integration. The verdict is still out whether Asia is capable of shaping a large Asian market more or less in the same vein as the Single Market in Europe.

There is no doubt, however, that the intention is there. China is aware of the political imperative to spread its newfound wealth among other Asian countries in order not to be seen as dragging wealth away from them with inevitable negative political repercussions. The South-east Asian countries are trying hard to create a kind of economic community in ASEAN. They know perfectly well that compared to the juggernauts China and India they cannot attract foreign direct investment unless they offer a common Southeast Asian market. For these countries, economic integration is a question of staying in league number one or be relegated to league number two. The ASEAN Charter, recently agreed upon, bears witness to that.²⁶

India is reluctantly warming to internationalization of its economic links with other Asian countries in a market economy framework.

Right now, China negotiates a free trade agreement with ASEAN and ASEAN negotiates a similar agreement with India. Recently, China and India have agreed to start negotiations about a free trade agreement. If all these efforts are successful, and it is more likely than not, Asia will in about ten years from now see some kind of single market, albeit less ambitious than the European one, but it will broadly speaking offer many of the

freedoms associated with a single market. Just think of such an economic powerhouse with approximately 3 bn. persons, growth rates around 7-8% and income per head moving into the bracket of 5.000 US Dollars. It constitutes a watershed in economic history. Enterprises will be offered freedom of localization and goods plus not all, but some services will cross borders without barriers. The high productivity in Asia will get a boost and the purchasing power will jump.

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The drivers will probably be China and India. Much has been written about the rivalry between these two powers. There are two things to say about this.

First, they may be rivals, but they do not constitute a threat to each other's vital interests. For China, Japan fills this role and for India Pakistan does, but the absence of conflicting vital interests opens the way for economic partnership.

Second, over the last year bilateral trade has increased phenomenally. From approximately 150 mio. US Dollars in 1992, it surpassed 20 bn. in 2006 and is expected to reach 50 bn. in 2010. Direct investments between the two countries are still embryonic, but rising fast.²⁷

3) *Asian multinational companies (AMC)*

The global market has been dominated by multinational companies originating in the West, framing business culture by corporate governance, corporate compliance and corporate social responsibility.

This will not last. So far, the only Asian multinationals have come from Japan with a handful Korean and one or two from a few other Asian countries. The Japanese multinationals, however, are not – with the exception of Sony and may be Toyota – genuine multinationals, but Japanese companies operating internationally.

The Chinese companies realize that their limited exposure to the market economy and seclusion from international and global trends forces them to buy – not market shares – but knowledge and skills about how to operate internationally. Having grown up in a strictly controlled Chinese economy, in an incubator controlled

by state banks far from market conditions and with state-owned enterprises as their role models, they are handicapped in the global competitive game from the beginning. It will take too long to learn by doing, so they opt for buying this expertise by purchasing well-run and well-known Western enterprises. The classic illustration is the Chinese PC maker Legend's purchase of IBM's computer division with the new company operating under the name of Lenovo with its headquarters in the US. The large Chinese oil companies like Petrochina and CNOOC are following the same trend. In the beginning of 2008, the Australians did not only wake up to a new year, but also to a new world. After several years worth of effort by Australian banks to enter the Chinese market, it suddenly dawned on Australia that China had bought stakes in the three leading Australian banks!²⁸

In a few years time, the world will see Chinese multinational companies challenging the established Western companies. They have a large domestic market, they know better than many Western companies how to fit into the demand patterns of newly industrialized countries or developing nations, having done so on their home turf, while Western companies are controlled by the philosophy in the US and Europe – not necessarily an asset as growing markets are to be found elsewhere.

The Indian companies have to a large extent grown up in a market economy, thus knowing well how to function under such circumstances. They do not need any learning process – witness the emergence of Arcelor-Mittal as the world's largest steel producer and the Tata Group as one of the few successful diversified corporations now contemplating to buy Jaguar, one of the household names in British motoring.

The world has already seen Wipro and Infosys in the software sector and it has not gone unnoticed how well-managed companies like Ranbaxy and Dr Reddy's Lab have been in the generic pharmaceutical industry.

4) Capital productivity

China and India are supplementing each other with regard to labor and capital productivity.

China has a comparative advantage in labor productivity, being approximately 50% better than India in this

regard, while India's capital productivity is approximately 30% better than China's.²⁹

In economic terms, the implication of this is not difficult to figure out. Multinationals can allocate their activities, taking advantage of the two countries' respective advantages to enhance competitive advantage. When companies from the two countries find out what this means the coming free trade agreement opens the door for a similar effect. The companies doing this in a market with approximately 2.3 bn. persons and high growth rates will see their unit costs nosedive, strengthening their competitive positions.

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This is, however, far from the whole story. The International Monetary Fund (IMF) has analyzed China's capital productivity.³⁰

The starting point is a rising proportion of investments as share of GDP from 1995 to 2005: for China from 33% to a little more than 40% and for India slightly rising from 25% in 1995 to 28% in 2005.

The IMF then looks closer at China. 41% of manufacturing assets are held by domestic non-state-owned companies, 32% by state-owned and 27% by foreign-owned ones. The point is that a given amount of investments by state-owned companies generates much less value added than other types of companies. Compared to domestic private companies, the figures say 32% less for wholly state-owned, 14% less for majority state-owned, slightly less for wholly foreign-owned companies and 10% more for majority foreign-owned ones.

If state-owned companies are turned into non-state-owned companies and if the assumption is made that they will then catch up with productivity in the non-state-owned sector, China then faces an enormous jump ahead in capital productivity.

This may or may not be the case, but we do know that the Chinese government is acting fast in promoting precisely such a conversion. It is not the same as saying that it will be successful nor that it will bring about a jump in productivity as mentioned, but it is likely that it will increase productivity markedly, albeit the size may be uncertain.

Taken together, this points to a strongly rising productivity in Asia, not leaving much time to pause and reflect for Western companies.

5) *International investment*

The key sentence when talking about international investment is simple: There is only one place in the world where savings take place – and that is Asia.³¹ The world is financed by Asia. So far this fact does not seem to have sunk in among Americans and Europeans because Asia has allowed Western financial institutions to shuffle around with its savings. This is no longer the case.³² The sub prime crisis revealed that the Western financial institutions behaved recklessly and in stark contradiction to all prescriptions of corporate financial governance. An Asian offensive to gain influence on ownership of the institutions investing Asia's savings is gaining speed.

It is a safe bet that from now on Asia will demand a say in how its savings are invested and not surprisingly Asia's own preferences will get higher, much higher, priorities. The next thing to happen is the emergence of Asian financial institutions getting stronger, not only in their domestic markets, but also abroad. Names such as ICICI from India and ICBC from China will be known around the world in a few years time. Insurance companies like China Life and Ping An are already on the offensive.³³ No wonder. When you sit on the world's savings with an economy predicted to continue in the fast lane you will gradually, but surely get your hands on the wheel.

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A phenomenon attracting more and more attention worldwide are the sovereign wealth funds (SWF; investment funds owned by governments). They have been known for a long time operating out of oil exporting countries, but Asia is now starting to flex its muscles as well. China is setting up the CIC (China Investment Corporation), which earlier this year bought a stake in Blackstone but now redirects its interest more towards Asian and Chinese investment opportunities.³⁴ There is

a strong interest among Western politicians and financial institutions about which policies these sovereign wealth funds are going to adopt. Regardless of that, their sheer size will revolutionize the international capital markets, with the inevitable result that Western financial institutions will lose market shares.

Asia needs to shift from ample supply of production factors to higher factor productivity.

Morgan Stanley has calculated that in 2015 the SWF will control 12 bn. US Dollars (the size of US GDP in 2006) surpassing total international currency reserves in 2011, with a Chinese fund as the biggest single operator.³⁵

The Risk Factors

No rose without a thorn. Admittedly Asia is facing a string of problems posing question marks whether growth will continue.

1) *Productivity*

Inside the box of economics, Asia needs to shift from ample supply of production factors to higher factor productivity. Over the last decades, labor and capital has been abundant. Labor supply has grown with a rising population and a favorable age pyramid. Savings have been strong, especially in China and India is catching up now. That has stimulated growth and in some cases has led to the question of inoptimal allocation of production factors.

This trend will not be broken, but it is unlikely that growth in factor supply will continue to be as favorable. China will reach a maximum of people in the bracket 19 – 60 years in about 2015 and savings cannot continue to go up. India will see a continued rise in population in the active age bracket for at least 25 years and the savings rate is on an upward trend, but in both areas it is unlikely that India can fully compensate for China.

As in all other examples of transition from developing economy to industrial or service economy, the shift must take place from growing supply of production factors to higher factor productivity. Will Asia be able to do that?

The answer depends on three main issues:

- Asia's ability to root out many of the inefficiencies in the form of corruption, nepotism, distorted markets and politically motivated investment. In short, Asia needs to get better governance.
- The Asian capital market has markedly improved over the last decade, not least bearing in mind the lessons from the financial crisis in 1997-98, but markets are still not working in an optimal way. One of the keys – and maybe the most important one in order to analyze whether Asia will be able to squeeze higher productivity out of production factors – is the reform of the financial system. Financial institutions scrutinize investment projects and decide where to channel the savings. It is also bell weather for social capital perceived in the way that trust in governments makes it more likely that people switch from gold and cash (foreign currency) to bank accounts.
- It is an open question how good Asia's corporate governance is compared to many Western companies. Many Asian companies are still anchored in family ownership. There is nothing wrong with that except that experience both in Asia and abroad tells us that transition from the first and maybe the second generation is an acrimonious process, which many companies have not been able to survive.

2) Political systems

In many respects, Asia's political systems have mastered economic growth remarkably well. For the populations of Asia, higher living standards are on top of the list of priorities and the political systems in almost all countries have delivered. In a way, they legitimize themselves by rising living standards year after year.

Meritocracy is one of the key words. Many Westerners seem to take the view that sooner or later transition towards a model more like the Western one will take place. That may or may not be the case. There is no law to history, however, saying that continued economic growth requires a political system like the one we see in Europe and the US.

Even though there is no agreement that democracy is the 'ideal' or 'the best possible' political model, there are today 'rising expectations' among the deprived or the youth, which are principally fuelled by information spread through globalized networks. There is a gro-

wing demand for good governance, accountability and transparency. This cuts across any 'brand' of democracy and is not associated with a particular model.

Behind the scene looms a problem which in unfavorable circumstances may overshadow most of the other question marks: What about the 'social losers'?

The problem for Asia is not whether it can or will shift to democracy as defined in the Western mould, but whether the political system can intercept the growing preferences for fundamental rights of freedom and deliver on that issue as it has on rising living standards.

Behind the scene looms a problem which in unfavorable circumstances may overshadow most of the other question marks: What about the 'social losers'? Asia has gotten used to high growth and rising employment. Much social welfare is still invested with the family. The concept of 'social losers' is not on the agenda, even if it goes without saying that Asia has its fair share of those not able to cope with the challenges. As long as growth is high, the number of social losers may be sufficiently small to keep it on the lower rungs of the ladder of political priorities, but if the business cycle turns it may pose a nasty challenge to Asia's political system.

3) Sustainable growth

Energy, the environment, water and inequality pose tremendous challenges for Asia, its political systems and economic model.

With the switch from growing factor supply to higher productivity, it ranks as challenge number one.

As in all other cases of transitional economies, Asia has given low priority to the environment and accepted inequality. Now they are high on the agenda as the Asian countries realize that unless something is done quickly with tangible effects growth may continue for a couple of years, but soon be brought to a halt.

Energy is said to be in short supply for China and India. This is not true. Both countries have an ample supply of energy, but do not want to use what they have: coal.³⁶ The reason is the deterioration of the environment which pushes both countries towards other energy sources such as oil, LNG, nuclear power and renewable

energies. So the problems of energy supply and the environment are linked and cannot be solved separately.

Water may be a vital problem for China in the longer run while it is not a problem for India.

The good news is that primarily China seems to be aware of these problems and pushes them high on the political agenda.³⁷ The bad news is that we simply do not know how responsive the lower echelons of the political system, the enterprises and the ordinary citizen are to these political signals.

The reaction to Asia's emergence as a global economic power has gone in two almost diametrically opposite directions.

In conclusion, we can say that the threats to Asia are there for everybody to see. What gives rise to guarded optimism is that the political leaders in most of the Asian countries have spotted the dangers and are trying hard to implement appropriate policies.

Europe's response

The reaction to Asia's emergence as a global economic power has gone in two almost diametrically opposite directions. Some politicians, business leaders and academics take the view that the Western world cannot compete and needs to defend itself by barriers against outsourcing and imports combined with strong pressure to erode Asia's competitiveness, among other things trying to force an appreciation of the Asian currencies. The opposite camp is composed by those thinking that Asian growth is an ephemeral phenomenon, sooner or later to be unmasked, stopped in its tracks by the inability to achieve higher productivity and cope with the environment, energy, water and inequality.

To my mind both of these positions are wrong and untenable.

First, the law of comparative advantage is still valid, meaning that the US and Europe have to find their competitive advantages under new circumstances.

Second, globalization opens the door for high growth and increasing wealth, but it is not confined to one or two geographical regions. The transfer of purchasing power from the US and possibly also Europe leads to a narrowing of the gap in income per head, but without depressing income per head in the US and Europe. In

absolute terms, all three regions may gain, but in relative terms Asia is the winner.

The problem for the Europeans and the Americans is that use of this competitive parameter requires structural changes, not only in the education system, but in the social fabric in the societies as a whole.

The US and Europe face a painful process, but they are far from being without hope and it is far less painful in the long run than doing nothing. The British historian Arnold Toynbee coined the phrase 'response to challenge', and this is precisely what the US and Europe face – economically and politically.

Economically, the Western world must realize that it cannot compete on costs. Trying to do so is a losing battle, increasing the burden and prolonging the pain. Instead, a shift towards performance and comparable competitive parameters must take place. The US and Europe need to analyze and define where their competitive advantages lie in today's and tomorrow's world. If the battle is fought on terms defined by the industrial era it is a lost one before it has even started. If the US and Europe are capable of choosing the ground where the competitive battle is to be fought it is not yet lost.

One of the encouraging omens is that one factor that may be decisive is the skills factor and this is where Europe rather than the US stands a fairly good chance to carve out a position for itself. The education sector with traditions and experience and a well-managed system is a sector where Europe and to a certain extent also the US are second to none.

The problem for the Europeans and the Americans is that use of this competitive parameter requires structural changes, not only in the education system, but in the social fabric in the societies as a whole. Darwin's key sentence that those who survive are not the strongest ones, but those best able to adapt will prove true.

One illustration is the combination of hardware and software as competitive parameters.³⁸ In this context, they are not perceived in the information and communications technology framework (ICT), but in general terms. Machinery and investment goods are nowadays rarely sold without a whole string of services like upgrading, training of personnel, maintenance, guarantee

of assistance within a specific time period in case of breakdowns etc. All indications point to a strong lead for Western companies in offering this complex of machinery and services.³⁹

Politically, the Western world lives in bubble, unable to comprehend that as economic clout changes so must political influence.

For Europe, as an 'old' continent there is no other way ahead than to change track, seek its competitive advantage and marshal the resources to support the sector(s). The competitive advantage is to be found in societal structures improving skills, competences, creativity and ingenuity, marshalling the society as a whole behind a production structure favored by the business and, to an even larger degree, technological cycle. Countries performing well in the industrial age will not necessarily be on top in the ICT age; witness the problems Japan, Germany, Switzerland and Sweden face – all of them envied 30 years ago – while countries like Finland and Denmark, which were in the relegation zone in the 1970s, have swung into gear, spurred on by ICT, and are now referred to as role models.

In a way, it can be put in quite simple terms: Europe must let die what cannot survive and strengthen those sectors already doing well. The slogan 'Do what you are best at, only that and nothing else' is the key for Europe's survival. The more money is sent to non-profitable sectors, the more unlikely it is that the turn-around will succeed.

Europe should also sense that the opportunities to get a foothold on the Asian markets are still open. European companies are welcome, they still bring along knowledge that is needed. Asian multinationals search for European partners. This may not last as Asia's economic power may be overwhelming some years from now. Politically, the Western world lives in bubble, un-

able to comprehend that as economic clout changes so must political influence. It can be said quite clearly: So far, the rising Asian economic powers have wished to join the existing global system and the world should be thankful for that. Just imagine the political turmoil if they had tried to set up a competing system. The *quid pro quo* is that the Western powers must accept this gracefully and accept that the system is adapted to accommodate the Asian powers. It is laughable to look at the International Monetary Fund and other institutions and the G-7 and/or G-8 trying to control the global economy as if most of the Asian economic powers did not exist.

Conclusion

It may be a long shot, but omens point to a seminal shift in economic and political power. Asia is starting to roll back what it lost to the Western industrialized world over the last 200 years. The drivers behind Asia's growth continue to be strong, although growth will not be as easy to come by like it was the case from 1979 until now. Asia's policy makers face harder choices, but basically the economies look set to produce high economic growth, delivering the financial resources needed to address problems and imbalances. We will see a new economic pattern with higher technology and Asian multinational companies shaping the growth patterns and emerging as robust global players. It will be fascinating to watch whether Asia is capable of designing its own pattern of economic (and maybe political) integration to serve as a framework for Asian growth and safeguard Asia's global economic and possibly also political interests. History tells us that economic power leads to political power, albeit the time lag may differ from case to case. The crucial point is whether the rise of Asia will be accompanied by a decline of the West or whether a new tandem will emerge to solidify globalization in more or less its present form.

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