MARIO DEAGLIO: : CHANGES IN THE MAP OF ECONOMIC POWER by Vittorio Borelli
EUROPE AND ITS ENVIRONS: IN SEARCH OF A MODEL
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# The sun rises in the East

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The U.S. is still in top place with about 28% of world production, closely followed by the European Union with a marginally lower percentage. The absolute star in terms of growth is China, which has now overtaken Japan, while the former Soviet bloc has dropped to under 10%. But the most noteworthy figure is that, in 2004, the Asian region accounted for



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# Deaglio: changes in the map of economic power

**edited by Vittorio Borelli**

*The U.S. remains the world's leading economy, followed at some distance by Europe. With Russia's economic weight now marginal, China has overtaken Japan to occupy third place. In relative terms, however, the new wealth being produced in Asia already accounts for over half of the total. Economist Mario Deaglio explains why, and points out the critical factors.*

Professor of International Economics at the University of Turin, Mario Deaglio has always been an intellectual with a particular sensitivity to communication and information needs. Professor Deaglio, a columnist for "La Stampa", was a long-time contributor to "The Economist" and is a former editor of "Il Sole 24 Ore". His recent books include *La nuova borghesia e la sfida del capitalismo (1991), Liberista? Liberale* (1996) and *Postglobal* (2004). Since 1996 he has written the Turin-based Luigi Einaudi Research and Documentation Centre's *Rapporto sull'economia globale e l'Italia (Report on the global economy and Italy*) either fully or in part. **east** interviewed Professor Deaglio on the topics covered in the latest Report, which describes the spectacular changes currently underway in the world economy's balance of power.

**Professor, I'd like to ask you for a quick initial roundup of the new nations and the new balances in the world economy. Who's going up, and who's on the way down?**

I'd start by saying that from the 1960s to1985 the geography of economic power in the world remained practically unchanged. We had a Soviet bloc that accounted for about 15% of the total, but the leading power was the U.S., followed by Japan, which consolidated its position in the 1970s, with the major European countries in third place – Germany, France, the U.K., Italy and the others. Taken as a whole, the Europeans outclassed the Japanese. That was the order. The sum of all these countries made up about 65% of gross world product on a purchasing-power-parity basis. It's important to make that distinction, because we sometimes say 80% based on market exchange rates. But if you check what was actually being purchased in the various countries with the same amounts of money, you'd come down to 65%.

over 50% of world production. Other countries are jumping onto the Chinese bandwagon: from Indonesia and Malaysia to Singapore and Taiwan. Two regional powers, Brazil and South Africa, also show an interesting growth curve. As regards the U.S.-China conflict, there are some parallel weaknesses

**What about the rest of the world?**

The U.S., Europe, Japan and the USSR combined accounted for 80% of gross world product. So the rest of the world accounted for the remaining 20%, i.e. very little.

**And then, in the 1980s, things began to change. What happened?**

The turning point as per my conventional classification was 1986, when the modern process of market globalization began. That was the year of the "Big Bang", as the liberalization of the London Stock Exchange is known; as a result, global funds began to flow in a freer legal setup and trading was automated. Capital now moved instantly all over the world, and this, combined with the collapse of the Soviet Union at the start of the 1990s, caused a very rapid modification of the old weights and balances. The scenario we now have, in 2005, as a result of these changes is this: the U.S. in top place with about 28% of world production, closely followed by the European Union, considered as a single economy, with – and this is the major new factor – China vaulting to third place with 13 %, overtaking Japan, which has dropped to fourth place with about 10%. The Soviet bloc has obviously vanished, and the former Soviet republics' share of the world economy has diminished sharply, from 15% cent to about 9%.

**So Asia is the new kid on the block.**

Together with China, India and the so-called "Asian tigers" make up about one-fourth of the world economy. But this is a classification in static terms. If we look at additional resources, i.e. how the new GDP produced in the world is distributed among the various countries, we find that the Pacific and Indian Ocean regions together account for 55% of all the new resources. The U.S. stops at 25%, Europe at 7% and the rest of the world at practically zero.

**Let's go into detail. In this year's Einaudi Centre report, you write that the U.S. is teetering: it remains the world's strongest country but is also the most indebted, and while the dollar is the reigning currency for international trade, its ups and downs depend on foreign investment.**

The U.S. is still at the centre of the international monetary flow. However, unlike what happened with Britain in the 19th century and up to WWI, the U.S. is heavily indebted and needs to keep attracting new flows of financial resources from the rest of the world merely to repay the old ones and pay the interest on its residual debt. This is the American paradox and weakness. The U.S. imports ¤2 billion worth of goods more than it exports each

**ANNUAL REPORT ON GLOBALIZATION**

*The 2005 Report by the Centro di Ricerca e Documentazione "Luigi Einaudi" of Turin, has a title which is perfectly in line with east's mission:* Il sole sorge a Oriente *(The Sun Rises In The East). The interview with professor Mario Deaglio summaries the first part, concerning the changes that the map of global economic power is presently undergoing. But the Report, published as a book by Guerini e Associati with the cooperation of Lazard, is much more extensive and very detailed. "The main event of these recent months", writes Gerardo Braggiotti in the introduction, "is the overwhelming claim on the world's attention by the great south-east Asian economies: India and especially China. Most of the world's growth in 2004 occurred in this region: this confirms the widespread belief that the planet's economic center of balance is moving from the Atlantic towards the Pacific".*

*In agreement with the Centro Einaudi, which we thank for their valuable cooperation, we will publish some parts of the report:*

- *Deaglio's essay on Europe searching for a role and an identity;*
- *Anna Lo Prete's article on the relation between companies and global power;*
- *some fragments of S. Frankel's long essay on the queen of raw materials, petroleum;*
- *extracts from Anna Caffarena's piece on US unilateralism and the strategy of George W. Bush.*

Grazia Neri_Bilderberg

_A modern Chinese railway station. Having started 30 years ago with annual per capita income of merely $300, China has grown steadily at an annual rate of 8-9%, and shows no signs of slowing down

day. How is it paying off this deficit? The simple answer is that it isn't paying, in the sense that other countries prefer to keep their surplus in the U.S., invested in banks or other financial activities. Obviously, if this confidence were to be lacking some day, the world economy would head for disaster.

**You use a very clever metaphor: you compare the U.S. to the Leaning Tower of Pisa, which is destined to fall sooner or later, but never actually falls.**

I'll go one step further and say that before the foundations were strengthened, mathematical models showed that it was certain the Leaning Tower would collapse sooner or later, although no one could say precisely when. In the case of the U.S. it's the same thing: it could happen tomorrow morning or within 200 years; no one can tell for sure. The U.S. deficit cannot continue to grow indefinitely. A terrorist attack, a tropical storm or any kind of unforeseen disaster could undermine confidence in the U.S. and cause it to topple in the space of 10 minutes.

**Well, maybe the U.S. will begin to tackle the problem.**

Yes, of course. The middle way between letting things continue as they are and a possible collapse is to import far less and accept all the consequences – a growth slowdown or even a recession, reduced consumer spending etc. The point is that all this is not neutral for Italy and Europe; our economies are no longer as closely linked to America's as they used to be. Until the end of the 1960s, the U.S. bought the bulk of its supplies in Europe. American imports of consumer products, which were far lower than they are today, came largely from the European countries. Even Fiat and Volkswagen managed to export to the U.S. at the time: who doesn't recall the movie *Herbie Goes*


*Bananas*? From the 1960s on, the Americans turned first to Japan and then to South East Asia and China. The Japanese not only supplanted the Europeans in terms of car exports to the U.S. but also actually transferred several factories to America.

**The foremost player in the changes of recent years is China, which you describe using another metaphor: that of Shanghai's World Financial Centre. The building will be the highest in the world once it is complete. Unfortunately, Shanghai's entire surface area is sinking by about 2.5 cm a year because of the overuse of underground water.**

China's growth should come as no surprise to anyone, because it has been growing more or less constantly for at least the last 30 years. It started at very low levels, of absolute poverty – we're talking about $300 a year per inhabitant – and progressed at an annual rate of 8 to 9%. We all thought it would slow down at some point, but that didn't happen and, as a result of compound interest, that initially low-level growth has turned explosive in the last few stages. China really took off around 2000.

**Why didn't it slow down as so many expected it to?**

That's a good question to which we don't have all the necessary answers. The sceptics would probably say: "Because it's a socialist economy". It's true that despite all the reforms, nearly 60% of China's GDP still comes from the State or government-connected enterprises. And State interventionism there is still very strong. We sometimes buy shares in Chinese electronics or aeronautics companies or other high-tech sectors and unwittingly become Chinese Army shareholders. China has definitely taken advantage of a weak exchange rate; in 1992 it

_Shanghai's World Financial Center project. It will be the world's highest skyscraper, but the fact that the land on which it is being built is sinking by 2 cm a year is no small cause for concern

THE COUNTRIES OF GROWTH IN 2004

| | |
|---|---|
| China+India+"Asiatic Tigers" | 44,5% |
| Japan | 10,5% |
| **Total South-East Asia** | **55,0%** |
| Latin America | 7,5% |
| Sub-Saharian Africa | 1,5% |
| Ex Socialist and Other Countries | 10,8% |
| **Total Other Emergent Countries** | **19,8%** |
| United States | 17,7% |
| European Union | 7,4% |
| **Total "Atlantic Area"** | **25,1%** |

ORIGIN OF ADDITIONAL WORLD PRODUCTION
(PERCENTAGE VALUES CALCULATED ON 1995 U.S. $, ADJUSTED TO EQUAL THE PURCHASING POWER)

| Countries and Groups of Countries | 1995-2000 | 2000-2005 |
|---|---|---|
| China, Hong Kong, Taiwan | 21,8 | 27,4 |
| Japan | 3,0 | 3,5 |
| "Asiatic Tigers" (1) | 4,5 | 8,5 |
| India | 8,0 | 9,6 |
| Total "Dynamic Asia" | 37,3 | 49,0 |
| United States + Canada | 26,1 | 15,6 |
| European Union of 15 | 15,0 | 7,1 |
| Transition Economies (2) | 4,2 | 8,4 |
| Sub-Saharian Africa | 2,1 | 2,7 |
| Others | 15,3 | 17,2 |
| World Total | 100,0 | 100,0 |

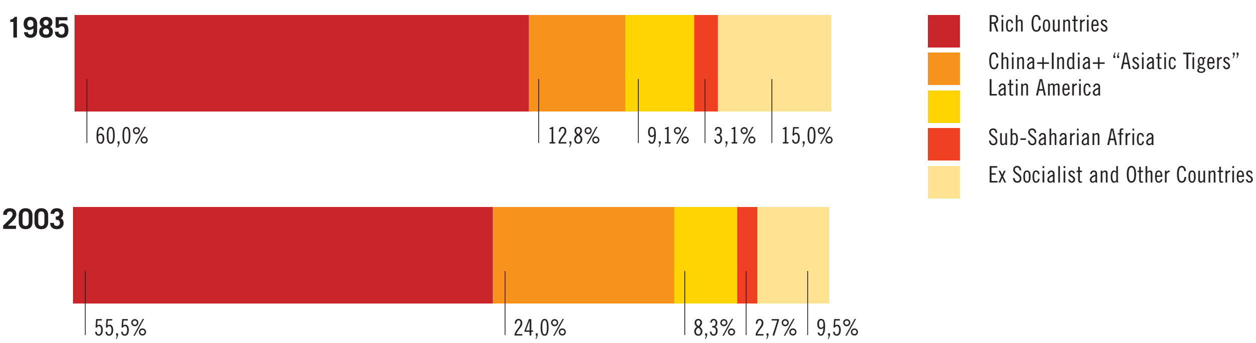
(1) South Korea, Indonesia, Malaysia, Philippines, Thailand, Vietnam, Singapore
(2) Economy of centre-east Europe according to the definition of the World Bank
Source: Elaboration on World Bank and IMF data for 2005, estimates

devalued the yuan by 20 to 30% and thereby gained a significant competitive advantage. Then its massive investment in human capital reached maturity. Just think: China turns out 500,000 graduates in technical and scientific subjects every year, about twice as many as Europe. As a result China has been able to rapidly master the technology it imported from the West from the 1960s to the 1980s and develop further variants of that same technology. To all of this we should add that China still has an enormous agricultural workforce – over half a billion people, the equivalent of the total workforce of the U.S., Europe and Japan combined. This "behind the scenes" activity feeds a 10 to 20 million strong transfer of manpower to industry and services every year. To recapitulate: we have low-cost manpower, human capital in large numbers, plus a State with active growth-oriented policies in every field. It is this mix, this combination of factors, that has made it possible for China to rise to its current level. And if you consider that the country pays for its imports with its exports, you begin to realise why China has become the world's leading producer in a series of major sectors, from steel to televisions and electronic components. Its textile production is 20 to 30% higher than Italy's. In short, this is growth with no precedent in modern economic history.

**However, you point out that Chinese managers are concerned about China's excessive production capacity.**

That's the flip side of the coin. It's precisely the Shanghai tower metaphor – it breaks a height record, but with a base that's sinking by over 2 cm every year. There is an extreme amount of precariousness. On the one hand there's social precariousness – there are 500 million rural Chinese knocking on well-being's door and they should be entering it gradually, but there's a huge pressure from underneath to get in immediately. On the other hand, there are dis-integrative tendencies that are due to the country's lack of homogeneity. We're used to thinking of China as a single entity. While it's true that China has a very strong State, which acts as a catalyst, there are also six or seven different ethnic groups and as many languages. Finally, there is a very worrying environmental dimension: not only is Shanghai sinking, but nearly all the rivers are polluted, and force feeding on breeding

QUOTAS OF WORLD GROSS PRODUCTION - 1985-2003
ON VALUES ADJUSTED TO EQUAL THE PURCHASING POWER



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farms leads to phenomena such as Sars. Nature ends up rebelling, and this generates additional precariousness.

**Japan has started growing again after a long period of stagnation, largely thanks to China. What does this imply in terms of world balance?**

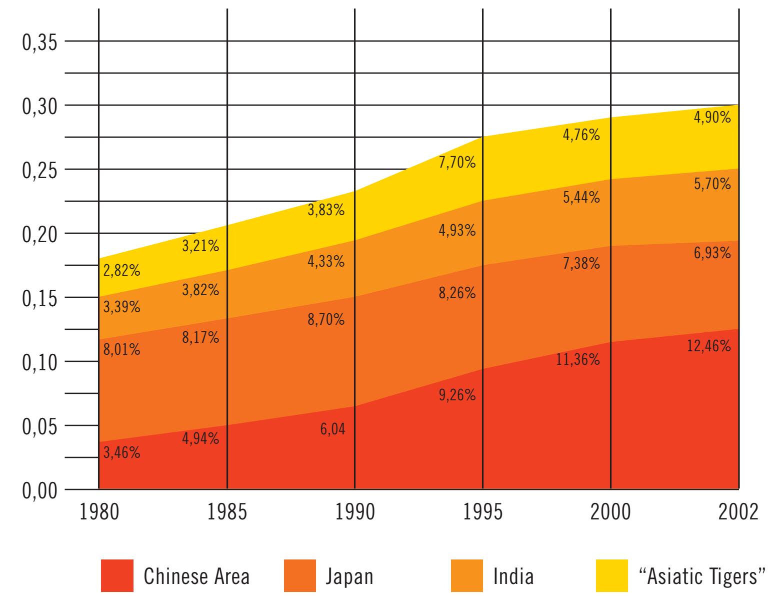
Japan's recovery is still fairly limited: in the range of 2 to 3% a year. The driving factor is trade with China. Not consumer spending, because the Japanese continue to consume sparingly, and not investments, which remain stationary. The push is coming from exports to China. The turning point came in 2003, when China and its geo-economic neighbours (Taiwan and South Korea) surpassed the U.S. as Japan's primary export markets. In addition, there are about a dozen countries in the region that have jumped onto the Chinese bandwagon in various ways, from Indonesia and Malaysia to Singapore and the Philippines. These countries also have large Chinese-speaking populations. There is an ever-increasing synergy among these countries and between these countries and China.

**India is growing independently, but is also building strong links with China.**

In this case too we are looking at incredible demographics – India, which now has over one billion people, is nearing China in terms of its overall population, although over a smaller land area. At 6 to 7%, India's growth rate is lower than China's while its population is growing faster, which means that the growth of per capita income is slightly lower than in China. India has achieved these results with an economy less influenced than China's by

_In a feasible, hypothetical division of world labour, says Deaglio, China would be the world's factory and Japan its financier, while India would be the back office and supplier of IT services

PERCENTAGE QUOTAS OF DYNAMIC ASIA ON THE WORLD PRODUCTION




Source: Elaboration of World Bank Data


central control: in India the army does not own joint-stock companies, and although there is a five-year plan it is very flexible. Besides, European social democracy has always been the Indian Congress Party's political and cultural reference point. Until seven or eight years ago India was a relatively closed economy; growth was prevalently internal, with planning methods that substantially slowed the exodus towards the cities. India remains a country with a population dispersed all over the territory. The interesting thing is the resulting type of development: China wants to become the world's factory, while India wants to become the world's office. Slogans and simplifications aside, India is focusing to a large extent on value-added services. It is a very interesting laboratory, which is applying for the bulk of the world's outsourcing needs.

**The fact that they speak English is a big advantage...**

Certainly. Indians follow an English-language curriculum and Indian universities are twinned with U.K. ones, which means they study the same subjects and guarantee similar end results. This undoubtedly makes the electronic transfer of corporate support-activity to India easier, especially from Anglo-Saxon countries. I've been told, for instance, that some American insurance companies get Indian doctors, who earn one-tenth of what their American counterparts are paid, to do X-ray reports via digital transfers. Basically, India is going ahead with a development model of its own that has major strong points.

**Do you see economic complementarity between China, India and Japan?**

In a certain sense, yes. Very broadly speaking, China handles industry, India services and Japan high-tech manufacturing and a bit of finance.


Grazia Neri_Bilderberg (2)

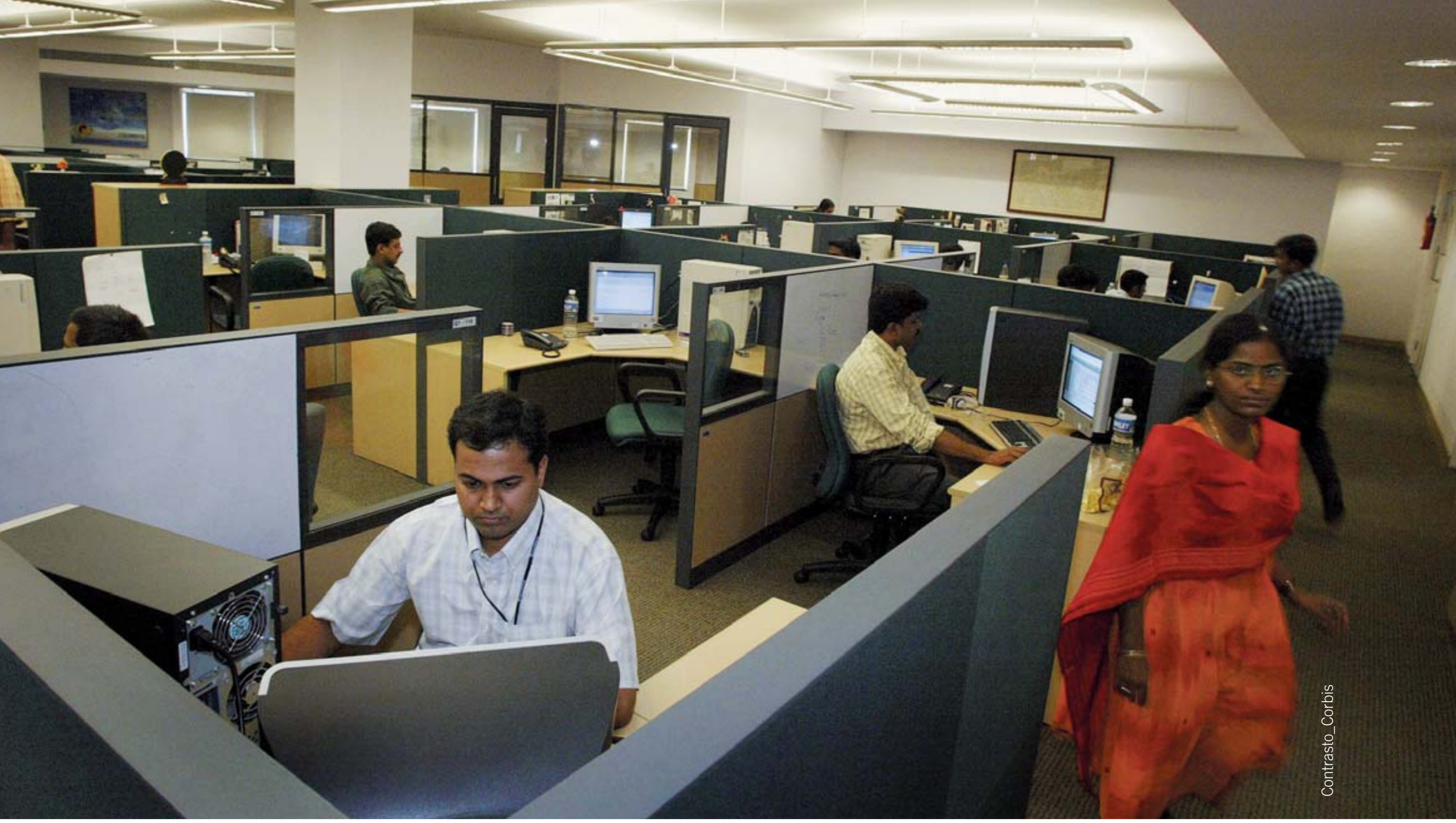
_Left: the Modern Centrum von Sapporo in Hokkaido. Above, the Fuji TV Building designed by Kenzo in Odaiba. Japanese growth has picked up again after a decade of stagnation, pulled along by the Chinese locomotive

**Where does Russia fit into the picture? Could it become the fourth pillar of the big Asian economic area?**

The problem is that Russia is "small" in terms of population. What's worse, its population is shrinking. Since the fall of Communism the birth rate has become negative; the average life span is five years shorter, and many Russians die young because there is a climate of huge personal frustration that drives them to smoke and drink too much. Russia has extraordinarily abundant untapped natural resources. As long as oil supplies last Russia won't have short-term problems and can start thinking about the future, not least because it definitely has high-level human capital and military technology that could allow it to play an important role. Having said that, however, I continue to think that from the economic point of view we cannot compare Russia to China and India.

**What about the geo-strategic point of view? Can we conjecture an Asian bloc including Russia as a counterweight to the U.S. and Europe?**

No, I don't think so; if anything, Russia could become part of Europe. We need their raw materials; we could offer to pay for these with euro bonds, and in exchange they could buy what they need from us – to rebuild their entire infrastructural network, for example. In the last few years, the EU has become the destination for three-quarters of Russia's exports. Russia has had lengthy periods of difficulty with Asia and is only now beginning to re-establish a relationship, but I don't think it's a relationship that will evolve in strategic terms. It is more likely that the disruptive tendencies in the Asian part of Russia will cause further changes in the composition of the Russian federation, obviously to China's advantage.



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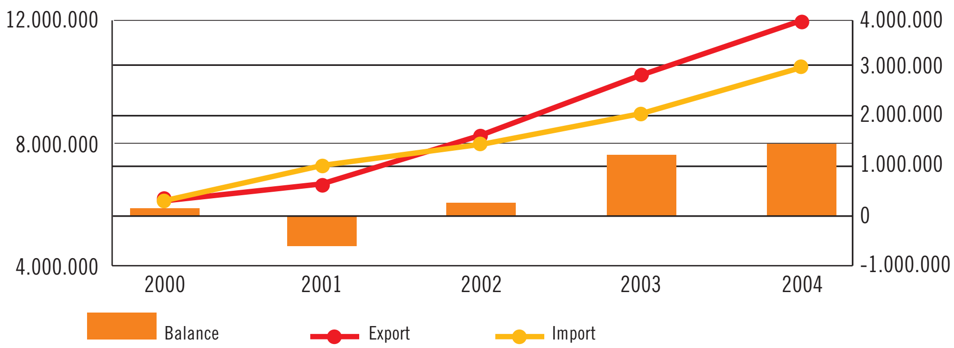
## JAPANESE TRADE WITH CHINA*
(DATA IN MILLION OF YEN)




* Hong Kong included Source: Elaboration of Japan Customs' Data

## THE "ASIATIC VOCATION" FOR FOREIGN TRADE OF SOME COUNTRIES
(PERCENTAGES ON VALUES IN CURRENT DOLLARS)

| | % of direct export to Asiatic countries | | | % of import from Asiatic countries | | |
|---|---|---|---|---|---|---|
| | 1997 | 2000 | 2003 | 1997 | 2000 | 2003 |
| China* | 43,5 | 39,3 | 40,5 | 51,7 | 53,2 | 49,0 |
| South Korea | 36,9 | 35,2 | 42,3 | 18,8 | 24,0 | 28,3 |
| Philippines | 26,1 | 33,3 | 43,6 | 31,9 | 36,6 | 38,6 |
| Japan | 42,2 | 41,3 | 46,3 | 37,2 | 41,9 | 44,6 |
| India | 22,4 | 20,6 | 25,4 | 15,9 | 17,2 | 23,3 |
| Indonesia | 36,7 | 38,2 | 40,7 | 28,9 | 38,6 | 43,6 |
| Malaysia | 46,4 | 44,2 | 48,0 | 36,8 | 41,8 | 47,4 |
| Singapore | 51,6 | 52,6 | 55,0 | 38,1 | 41,6 | 45,8 |
| Thailand | 37,7 | 25,6 | 40,3 | 28,0 | 33,2 | 25,8 |

* Hong Kong included Source: IMF – Direction of Trade Statistics


**Russia and China are now at peace...**

The real news, in fact, is that peace has descended on the entire region without us noticing it. The once-militarised border between Russia and China is now peaceful and easily crossed; thousands of Chinese workers cross the border every day to go to work in Russia. In the summer of 2005 Russia and China carried out significant joint military manoeuvres; India and China, which once fought a war, have not only signed a peace treaty but, as we said earlier, are also building various economic ties. India and Pakistan, in their turn, are making peace. Finally, there is growing cooperation among the ASEAN countries. To sum up, there are far fewer areas of tension, which makes the development of reciprocal relations easier.

**What about countries such as Brazil and South Africa?**

These countries can become leaders in their regions and play an autonomous role as regional powers. But we're looking at a future with a lot of question marks. India has 150 years of solid British administration behind it and China's history spans a few thousand years, whereas in Brazil and South Africa we do not have consolidated situations; we have flashes of fervent activity, but it is difficult to imagine a spectacular evolution over the next 10 years.

**You repeatedly mention two factors: demographics and energy. How do these influence the shift in the global balance of power?**

Population change is the real basic trend we have to reckon with. When Europe colonised the world it was backed by a strong growth in its own population. Demographic trends can't *not* influence economic trends in the long term. The (mainly American) idea of being able to continue to dominate the world through technological superiority is wearing thin. Americans themselves are starting to realise that their dominant position is

_Left: an image of the new India, a huge world software producer. Above: Chinese at a customs check. Asia has been at peace for the last few years only good for another 20 years or so, which is why they're trying to play an advance game both politically and strategically. As regards energy: our children will definitely see the end of oil, but it's hard to say exactly when and how this will happen. Some possible substitutes are starting to emerge, but none of them can do all the things that petroleum does. Petroleum is used to produce fuel, electric energy, plastic materials and a huge number of other chemical products. None of the available substitutes does all these. Everything will depend on how oil prices evolve and the time frame available to us to convert economies that are heavily dependent on oil.

**I'd like to end by asking your opinion on the type of capitalism we are heading towards. The Asian locomotives, India, China and Japan, have very different political, social and economic models. The U.S. and Europe have a solid common base, but differ in terms of the welfare system and social relations in general. As for Russia, Brazil and South Africa, they are still, in Pirandellian fashion, in search of an author…**

The State and the market are the two fundamental ingredients of any economic and social model, but the mix of the two can vary greatly from one country to the next. The type of capitalism we have in Italy is different not only from the American model but from the French and German ones as well. Today, the French are considering a legislation that would prevent foreigners from launching takeover bids for their companies. The Italians still have a model in which family capitalism plays an important role. The U.S. has considerably reduced the role of the State in the economy, but if necessary the American State can be extremely efficient. China is a still a hard-to-interpret hybrid. There is no single model; there will always be mixtures, and the combination of State and market will take on different forms over time. We're all a bit mixed-race in economics as well.