

# The changing geography of international trade: China, India and world trade

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Mark began his career as an economist in the Bank of England's international divisions, where he focused mainly on emerging market issues. He also spent some time in the Bank's UK structural economic analysis division. He subsequently joined JP Morgan, where he was a vice president in the economic research department with responsibility for Central and Eastern Europe. Before joining the Lowy Institute, Mark was senior economist at the Australian Export Finance and Insurance Corporation from 1999 to 2003, where he worked on country risk issues, with a particular emphasis on East Asia.

## Outline

- **A long run perspective – back to the future?**
- **The global context – the rise of international economic integration.**
- **The Dragon and the Elephant – China and India compared.**
- **China and world merchandise trade – the world's factory.**
- **India and world services trade – the world's back office?**
- **Powering growth – China, India and resources.**
- **Some policy implications.**

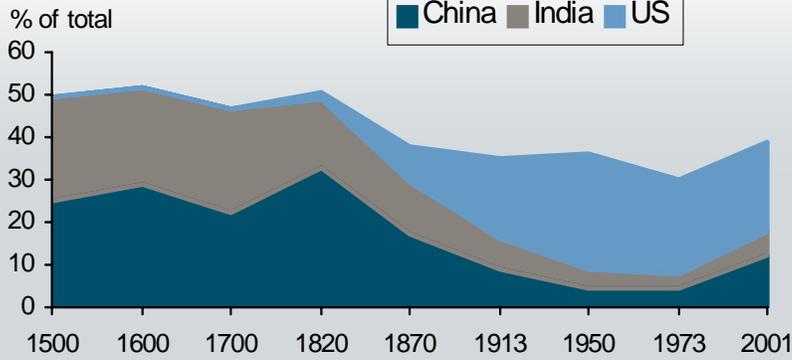
In this presentation I've been asked to take a look at the economic rise of China and India, and more specifically, to think about some of the resulting consequences for the international trading environment.

## **A long run perspective**

Before we get to the meat of the presentation, it's worth taking a quick look backwards and forwards in time and reflecting on the long term role of China and India in the world economy.

## The distribution of global output over time

### Share of world GDP



Source: Angus Maddison *The World Economy: Historical Statistics* OECD (2003)

Start by looking backwards: what does economic history tell us? According to estimates constructed by Angus Maddison, China (29%) and India (22%) between them accounted for more than half of world output in 1600. By 1820 their combined share of world GDP was still only a little under 50%. But the following decades brought a steep decline in the relative importance of both economies, leading to a combined share of less than 8% of world output (China 4½% and India 3%) by 1973.

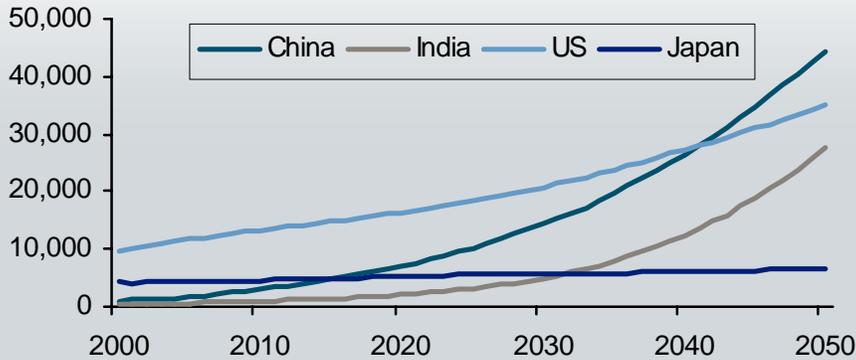
By 2001 the combined share of the two economies had risen to almost 18%. Seen in the context of economic history, the current increase in the weight of both countries in the world economy looks like (the start of) a return to earlier pre-eminence.

(Technical note: Maddison uses purchasing power parity (PPP) converters to construct comparable GDP estimates. Using PPP adjusts for differences in the price of goods and services across countries to allow for consistent measure of output. There is an ongoing debate about whether PPP or market exchange rates (MERs) are more appropriate for making international comparisons. One common approach is to use PPP-based estimates for comparing welfare and MERs for measuring international 'influence' (on the grounds that international transactions take place at market exchange rates). While PPP measures are often criticised as artificial constructs, there are significant problems with making MER-based comparisons. Think for example of the scale of annual fluctuations in nominal exchange rates which bear no relation to shifts in real output but which could have major measurement implications.)

## The shape of the future? One scenario

### Goldman Sachs BRICs projections

2003 US\$ GDP, billions



Source: Wilson and Purushothaman *Dreaming with BRICs: The Path to 2050*. Goldman Sachs (2003)

Next, look ahead.

One projection that has received a lot of attention in the last couple of years was produced by two Goldman Sachs economists in 2003. They estimated that in US\$ terms, China was likely to overtake the US as the world's largest economy some time after 2040, while India would push Japan out of the third place spot in the previous decade.

If the appropriate metric is PPP-based measures, then China could potentially overtake the US a fair bit earlier. For example, one *very* crude approach – which involves simply straight-lining the recent growth performance into the future – would have China in pole position within 20 years. Similarly, projections based on recent consensus forecasts for the medium-long-term outlook would put the date that China will become the world's largest economy at around 2015.

Of course, there are major problems with such naïve projections (what about economic or political crises, for example?). But they do give some context to the proposition that the global economy is currently seeing a return to the economic predominance of Asia.

## The global context

Let's bring the focus back to the present. I want to begin with the global context for the (re-) emergence of these two billion-people-plus countries into the world economy.

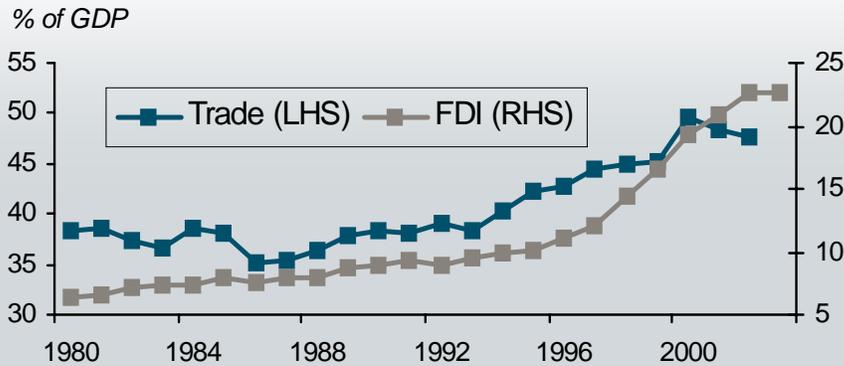
Specifically, the final decade of the previous century was marked by a sharp rise in international economic integration - 'globalisation' - driven by a combination of technological change (manifested in falling transport and particularly communications costs) and liberal economic policies (reduced barriers to international trade and investment). The result has been a marked increase in cross-border flows of goods, services and capital on a scale sufficient to warrant the description of a *new global economy*.

The integration of China and India into this new global economy should be seen both as a contributory factor to, and a consequence of, the process of rising economic integration. Thus China's shift from communism to market (state?) capitalism along with India's later, more gradual, move away from an inward-looking socialist model, between them expanded the (theoretical) reach of international markets to more than two billion people. These developments, together with the fall of the Soviet Union, made the international economy truly global. (Harvard's Richard Freeman notes that as a result, by the year 2000 there were almost 6 billion people in the world economy, rather than the roughly 3 billion that would otherwise have been the case. This 'great doubling' is a defining feature of the current international economy.)

At the same time, the economic development of both countries has also been a *product* of the greater cross-border flow of goods, services and capital. For example, China's development process has relied heavily on foreign direct investment (FDI) and access to global markets for China's exports. India's model has been more 'home grown', but nevertheless has benefited from the growing 'tradeability' of services brought about by lower communications costs.

## More international economic integration

### World trade and inward stock of FDI



Source: World Bank World Development Indicators on line; UNCTAD FDI database

This chart shows a couple of examples of the growth in international economic integration.

Thus while the share of trade in world GDP in 1990 was about 38% - or roughly the same as it had been in 1980 - by 2000 it had risen to almost 50%. The stock of global FDI rose from 6% of world output in 1980 to 9% in 1990 before leaping to almost 20% by 2000.

One feature of the new global economy is that trade and FDI appear to have become increasingly complementary. 'Old style' trade theory would tend to see them as substitutes (eg FDI to sell into markets that were protected by trade barriers). But now FDI is often motivated by a desire to cut production costs by locating different stages of the production process across different geographical locations according to comparative advantage (a process known variously as 'vertical specialisation', the 'disintegration of production', 'slicing up the value chain' or 'outsourcing'). Two of the driving forces of international economic integration - falling communications costs and lower trade barriers - have been major contributors to this trend - leading to a big change in the way geography interacts with location decisions for MNCs.

## **The Dragon and the Elephant**

Where do China and India stand *now* in this new global economy?

## Comparisons: GDP and population

(2004)	China	India	US
GDP (market exchange rate)	US\$1,649.3b	US\$691.9b	US\$11,667.5b
% of world total (rank)	4.0% (#7)	1.7% (#10)	28.5% (#1)
GDP (PPP)	\$7,123.7b	\$3,362.9b	\$11,628.1b
% of world total (rank)	12.7% (#2)	6.0% (#4)	20.8% (#1)
Population	1,296.5m	1,079.7m	293.5m
% of world total (rank)	20.4% (#1)	17.0% (#2)	4.6% (#3)
GNI per capita (MER)	US\$1,290	US\$620	US\$41,400 (#5)
GNI per capita (PPP)	\$5,530	\$3,100	\$39,710 (#3)

Sources: World Bank on line indicators. Rank reported for top 20 economies only.

This table compares the two economies with the current world economic (and political) leader, the US. In terms of GDP, both China and India are already large economies, although their relative standing looks much more impressive using PPP-based measures, which make them the second and fourth largest economies in the world in 2004.

It is also worth noting that the Chinese economy is much larger than the Indian one – more than double its size – but still significantly smaller than the US.

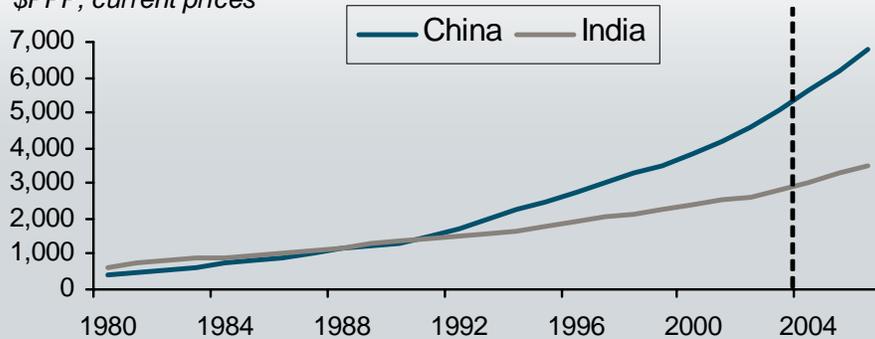
Note also that the GDP numbers are in large part a reflection of huge populations: the two countries between them account for more than one-third of the world's population (although they now have very different demographic profiles).

Hence cross-country comparisons of *per capita* wealth reveal a much bigger gap with the US. For example, using PPP rates China's Gross National Income (GNI) per capita ranks it at 116<sup>th</sup> in the world, while India is 145<sup>th</sup>. So while both economies have been successful in closing the gap with the leading developed economies in terms of the absolute size of their economies, the gap in terms of income per head remains substantial.

## Divergent growth paths

### GDP per capita

\$PPP, current prices



Source: IMF World Economic Outlook database April 2005: forecasts for 2005 and 2006

Does comparing China with India make sense? Despite being very different (in terms of culture, political and economic history, structure of economy) in practice the two economies *are* typically used as comparators . . . as in this presentation! In large part the comparison reflects the fact that these are the world's only two billion-people-plus economies. But it is also an interesting one to make since as recently as 1980 the two economies were relatively close in absolute size (GDP), while in terms of GDP per capita India was in front. In the following decades, China has moved sharply ahead both in terms of the level of GDP and in terms of living standards as measured (imperfectly) by GDP per capita.

This performance differential has encouraged various musings on the benefits of the two growth models on offer, the costs and benefits of democracy in terms of economic development, and the impact of geo-strategic competition on changes in economic policy (was India's later decision to revise its economic model in part a response to the success of China?).

## Comparisons: trade in goods and services

(2004)	China	India	US
Merchandise exports	US\$593b	US\$73b	US\$819b
% of world total (rank)	6.5% (#3)	0.8%	9.0% (#2)
Merchandise imports	US\$561b	US\$95b	US\$1,526b
% of world total (rank)	5.9% (#3)	1.0%	16.1% (#1)
Comm. services exports	US\$60b	US\$32b	US\$319b
% of world total (rank)	2.8% (#9)	1.5%	15.2% (#1)
Comm. services imports	US\$70b	US\$38b	US\$259b
% of world total (rank)	3.3% (#8)	1.8% (#15)	12.4% (#1)

Sources: WTO World Trade Report 2005. Rank reported for top 20 economies only

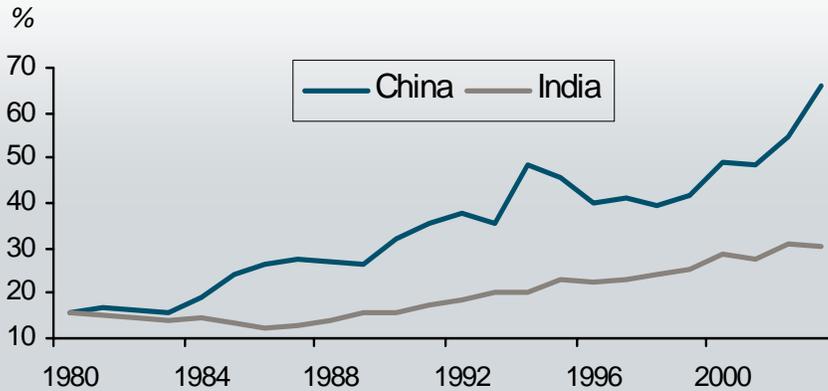
This comparison table narrows the focus to international trade. Here we can see that there is a noticeable difference in the global impact of the two Asian giants, with China enjoying a greater presence in world markets.

This is most evident in terms of merchandise (goods) trade. China is now the world's third largest exporter, for example, accounting for more than 6% of global goods exports. In contrast, India has a much lower profile, with a world market share of less than 1%.

In terms of overall commercial services trade, India is relatively more important, but is still some way behind China.

## Different levels of international integration

### Share of trade in GDP



Source: World Bank World Development Indicators

Differences in global market shares reflect the two economies' quite different levels of integration with the international economy.

One common way to gauge changes in the level of international integration is to look at the share of trade (exports plus imports of goods and services) in GDP. In India's case this ratio stood at about 15% in 1980, and was still at 15% in 1990. The shift to a more open economy in the 1990s then saw a fairly impressive increase, with the ratio roughly doubling to around 30% by 2003.

China has seen its ratio of trade to GDP more than quadruple over the 1980-2003 period. China's trade to GDP ratio also stood at around 15% in 1980, but by 1990 it had risen to about 32% (more than double that of India in the same year), and by 2003 stood at 66%, again more than double the Indian level.

This indicator is a measure of *outcomes*, but *policy* indicators tell the same story. For example, at the start of the 1990s the simple average tariff level in China was around 40%, compared to almost 80% in India. Both countries had moved to more liberal trading regimes by 2001, but China remained much more open: the corresponding tariff levels were 15% in China and 31% in India.

Beijing has pursued a development model that has been highly geared to the new global economy. More recently, New Delhi has started down a similar route.

## Comparisons: foreign direct investment

(2003)	China	India	US
FDI (inward flow)	US\$53.5b	US\$4.3b	US\$29.8b
% of world total	9.6%	0.8%	5.3%
FDI (inward stock)	US\$501.5b	US\$30.8b	US\$1,534b
% of world total	6.1%	0.4%	18.6%
FDI (outward flow)	US\$1.8b	US\$0.9b	US\$151.9b
% of world total	0.3%	0.1%	24.8%
FDI (outward stock)	US\$37b	US\$5.1b	US\$2,069b
% of world total	0.5%	0.1%	25.2%

Sources: UNCTAD World Investment Report (2004)

We noted earlier that trade and FDI are increasingly complements, rather than substitutes. Here too, there is a marked difference between the dragon and the elephant. In 2003 inward FDI into China exceeded US\$50b (making it the world's largest recipient), while India received less than 10%. In terms of cumulated stocks, the gap is even larger. (Once differences in measurement are taken into account, the gap narrows, but China remains well ahead.)

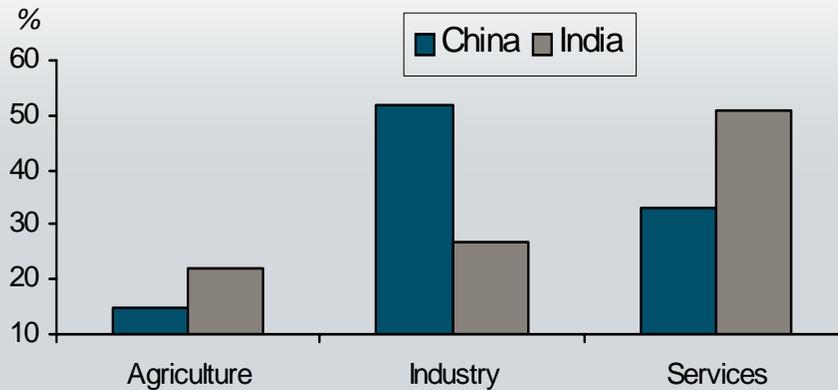
A *qualitative* difference here is that FDI in India has historically been directed towards servicing the domestic market, while in China foreign companies have also invested in China as an export platform, and not just to reach the domestic market.

One final point to note: in terms of *outward* FDI both economies remain very small players in the global economy – not surprising given their level of development. But there are already signs that Chinese and Indian companies will be bigger players going forward – which as we have already seen (think CNOOC's bid for Unocal) will have interesting policy and political implications.

Note: initial data for 2004 show China's inward FDI at US\$6.2b (9.6% of world total) against US\$6b (1%) for India and US\$121b (19.8%) for the United States, with the latter now back in pole position.

## Different development models . . .

### Structure of GDP (2003)



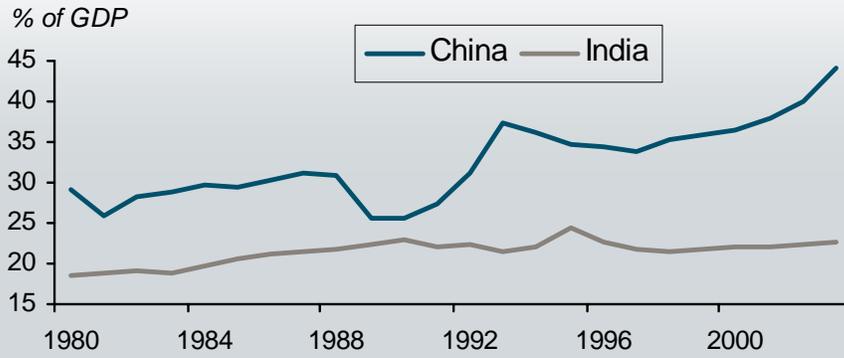
Source: World Bank World Development Indicators on line

The different outcomes in terms of international economic integration and market shares described in the previous tables and charts are in turn a reflection of the quite different development models that have been pursued by Beijing and New Delhi.

The differences can be seen most starkly in the structure of GDP of the two economies. Crudely put, China has followed a 'standard' development path for an emerging market, moving out of agriculture and into industry. In 2003, industry accounted for more than 50% of Chinese GDP. In contrast, the Indian economy is oriented much more towards services (again the sector accounted for more than 50% of GDP in 2003).

## ... and different development stories

### Gross fixed investment



Source: World Bank World Development Indicators

China's growth / development story can be told in terms of high levels of investment – both foreign and domestic – that have been ploughed into expanding industrial capacity and upgrading the country's infrastructure. This in turn has been combined with a large, relatively cheap labour force to power a formidable manufacturing export machine.

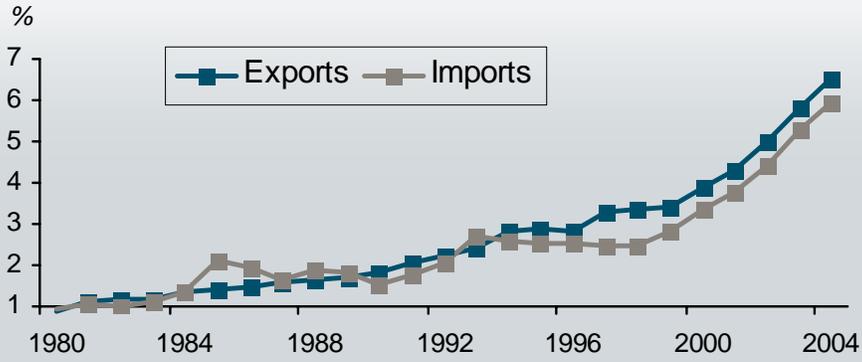
In contrast, India has had much lower investment (and savings) rates, and a much lower reliance on foreign capital.

To date, the Chinese model has clearly delivered the stronger growth results. However, some have argued that India's development model of relying more on home-grown entrepreneurs than FDI may turn out to be more successful in the long run.

**China and world merchandise trade:  
'the world's factory'**

## A new force in world merchandise trade

### China's share of world merchandise trade



Source: WTO International Trade Statistics database

In fact, the title should probably be a rising force in merchandise trade, as China's presence is no longer that 'new': over the past two decades, and particularly since the turn of the century, China has become an increasingly influential player in terms of global goods trade. China's share of world merchandise exports had jumped from less than 1% in 1980 to around 6½% by 2004, while its share of merchandise imports had risen from 1% to almost 6% over the same period.

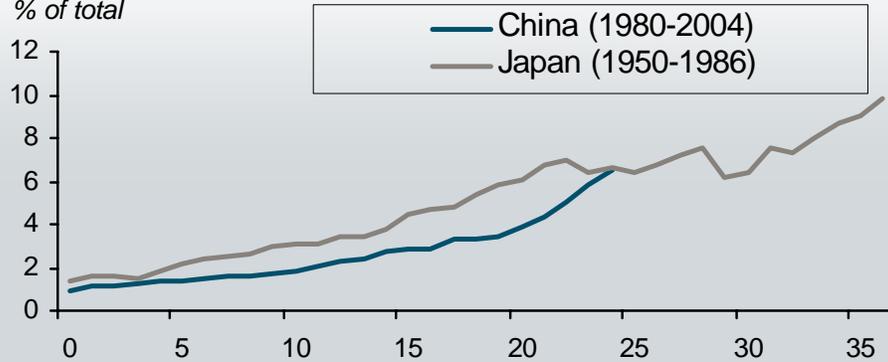
China's rapid growth in market share is a product of extremely strong export (and import) growth: during most of the second half of the 1990s China's merchandise exports grew at twice the pace of world exports, and since 2000 China has been the single most important contributor to the overall growth in world trade.

Foreign capital has played an important role in this process: official Chinese estimates suggest that the share of exports produced by so-called foreign-invested enterprises was 57% last year.

## Following the Japanese path?

### Share of world merchandise exports

*% of total*



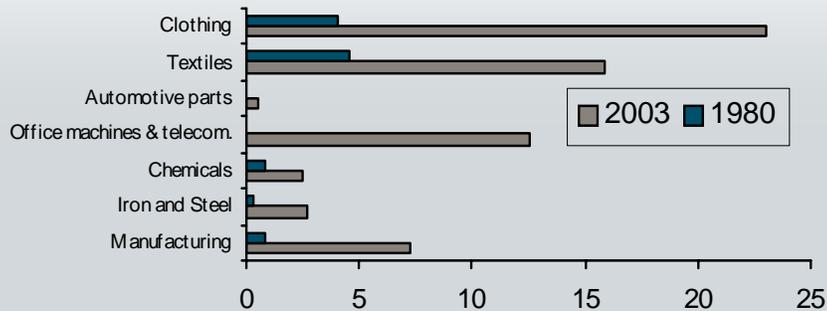
Source: WTO International Trade Statistics database

Is this kind of rapid trade growth sustainable? Comparisons with the past experience of other East Asian economies such as Japan suggest that the potential for further expansion of trade remains substantial. In fact, China's much greater size than its regional comparators (and much lower relative income level) suggests that its ultimate share of world trade could be even greater than regional precedent might suggest.

## A growing share of global markets

### Share of selected world export markets

*% of total*



Source: WTO International Trade Statistics 2004

China's growing role in international trade has been concentrated in global manufacturing, prompting descriptions of China as the 'world's factory'.

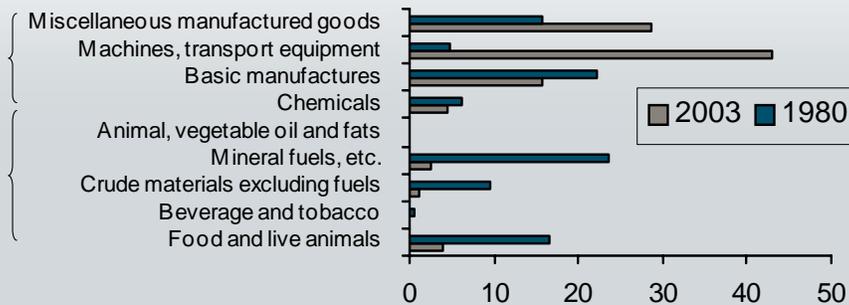
From accounting for less than 1% of world manufactured exports in 1980, China's share had risen to more than 7% by 2003. In the same year Chinese exports accounted for 23% of world clothing exports and 16% of world textile exports. (And with the expiry of international quotas for textiles and clothing at the end of 2004 (codified by the ATC), China's share of both sectors is widely forecast to climb significantly – hence the current protectionist responses in Brussels and Washington.)

Exports of clothing and textiles are exactly the sort of labour-intensive, low-end manufactures that developing countries are expected to specialise in at the start of the international integration process. But China is also an increasingly important player in more advanced products such as electronics exports, accounting for example for almost 13% of world exports of office machines and telecommunications equipment in 2003.

## China's evolving export structure

### Composition of exports

*% of total*

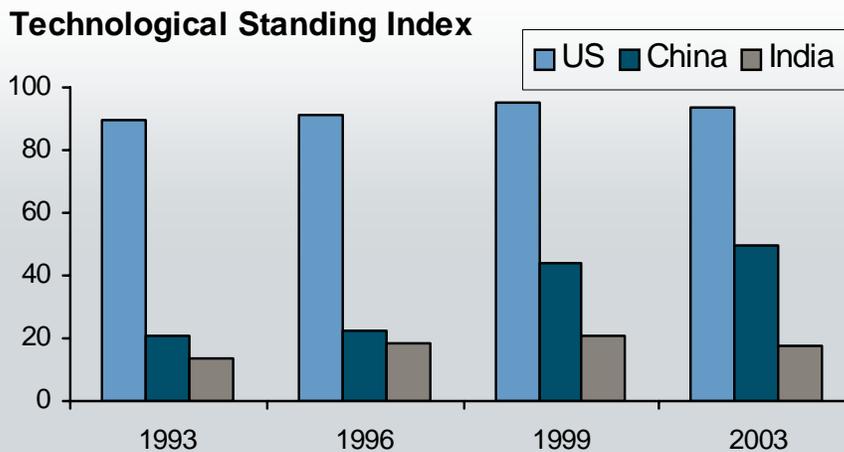


Source: China Statistical Yearbook 2004

China's evolving trade profile is visible in the structure of Chinese exports. Thus in 1980 China's merchandise exports were split roughly evenly between primary goods (food and live animals, beverage and tobacco, raw materials, and fuels) and manufactures. In contrast, by 2003 the share of manufactures had risen to more than 92% of merchandise exports, with one category (machinery and transport equipment) comprising about 43% of the total.

Turning to the import side of the trade process, in 2003 roughly 82% of Chinese imports were manufactures as against around 18% for primary products. The largest single import component (47% of total merchandise imports) was again transport and machinery. This import profile reflects China's increasing importance as an assembly point in regional and international production chains. A strengthening trend in the balance of trade in transport and machinery suggests that more production is now being sourced domestically, however.

## Technological catch-up?



Source: Georgia Institute of Technology

As noted, China's comparative advantage has seen it take a growing share of low-end manufacturing such as textiles and clothing. But China is also an important player in so-called high technology sectors. What are the signs that China can continue to increase its presence at the upper end of the market? One attempt to measure this potential is Georgia Tech's technological standing index - an indicator of a country's success in exporting high technology products which combines statistical data (the value of high tech exports and electronics exports) with survey evidence. This indicator shows that China has closed the gap on the world leader in recent years, although that gap still remains substantial; some commentators argue that China remains heavily dependent on FDI for technological know-how, and that domestic technological capacity is still relatively weak.

(Notes: 1. The index's emphasis on electronics exports means that India - which has concentrated on IT *services* rather than hardware - comes out relatively poorly. 2. To once again take a long term view, historically China was a technological leader probably at least up until the mid-late fifteenth century.)

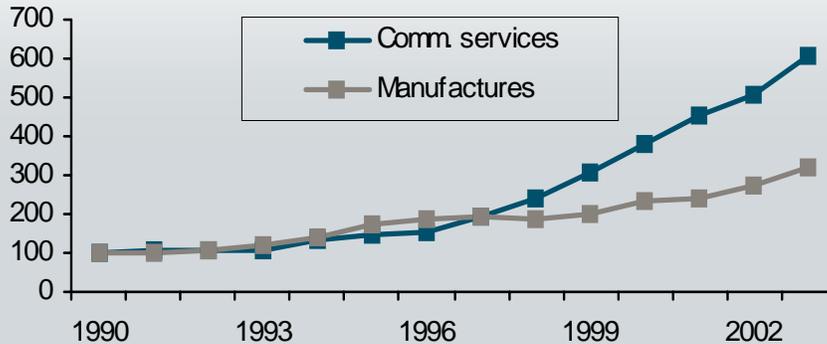
There is an interesting issue here. Standard models of North-South trade have the advanced economies of the North producing new goods reflecting advantages in R&D and skilled labour, while the South produces more mature products once the technology has become sufficiently diffused, with production based on cheap labour (think also of the product cycle model). But in the new global economy, increases in the pace of technological diffusion combined with growing indigenous *skilled* labour (in large and relatively elastic supply) in economies such as China and India may mean that such old models of trade no longer fully capture what's happening in world markets.

**India and world services trade:  
'the world's back office'?**

## India has focused on services . . .

### Indian exports of services and manufactures

Index: 1990=100



Source: WTO international trade statistics database

While manufacturing has been central to the Chinese story, in the case of India it has been the service sector that has attracted most attention. During the 1990s India's service sector grew at an annual rate of 9%, contributing nearly 60% of overall economic growth. The performance of services *exports* was equally impressive over this period, with growth running at over 17% pa.

Advocates of the Indian model argue that the New Economy can leapfrog India's hitherto poor physical infrastructure – a major constraint on developing local manufacturing capability. (India's infrastructure spend is a fraction of China's (in 2002: US\$31b v US\$260b, although the Chinese figure is inflated by real estate). They also claim that India is uniquely suited to a 21st century economy driven by services, after having missed out on the so-called Manufacturing Revolution that powered much of 20th century growth, and can now leverage its large supply of cheap, English speaking and relatively well-educated labour to jump-start development. Clear attractions of such a services-based model include not just the number of jobs that could be attracted in the service sector, but also their *quality* – fairly well paid, environmentally friendly, and human capital rather than physical capital or resource intensive.

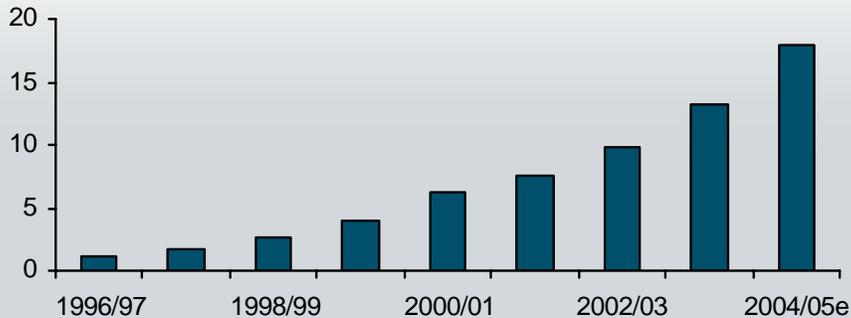
Sceptics counter that the services sector remains an enclave, employing only a small fraction of India's workforce (on some estimates, the IT sector accounts for less than 0.25% of the employed Indian labour force) and argue that 'real' development still needs the old manufacturing model.

Note: Commercial services exports (commercial means excluding government services) comprise three broad categories: transportation, travel and 'other'.

## ... particularly 'offshore outsourcing'

### Indian IT-ITES exports

US\$ billions



Source: NASSCOM

According to NASSCOM (India's National Association of Software and Service Companies), the Indian IT-IT Enabled Services (ITES) industry in 2004-05 was worth around US\$28.2b, or about 4% of Indian GDP (exports plus domestic production). The sector comprises IT services and software (roughly 59%), ITES-Business Process Outsourcing (BPO) such as call centres (about 20%) and hardware (about 21%).

NASSCOM estimates that India currently captures less than 2% by value of global spend on IT-ITES. (The biggest market is the US – about 47% of global IT-ITES spending.)

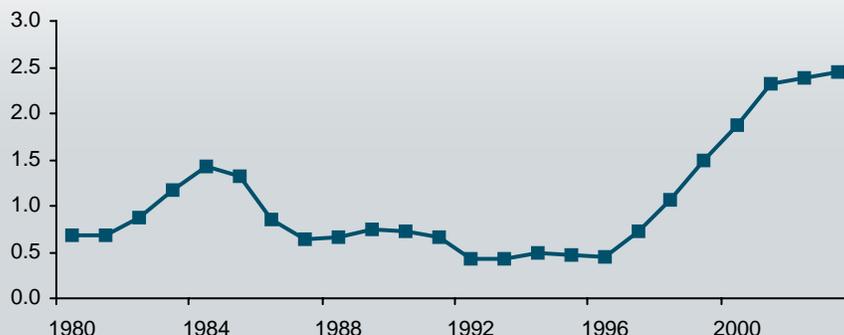
(Note that it is possible that these NASSCOM numbers are over-estimates: for example, there's a big gap between US and Indian estimates of bilateral trade in IT-ITES. Possible explanations include the fact that a large (but falling) share of India's 'software exports' are delivered onsite – which might be viewed as local sales of foreign affiliates, or provision by local residents (if present for more than one year).

Estimating the true size of offshored service activities is difficult, given that the relatively new nature of the phenomenon means that most official statistical sources are inadequate, and with most available information based on private surveys and anecdotal evidence. Surveys suggest that IT and software expenditure globally was in the order of US\$650b-US\$710b in 2003. Total outsourced IT services (ex software) were about US\$40b-US\$45b in that year, while world exports of business services were around US\$500b, and total commercial services exports US\$1.8 trillion. Balance of Payments (BOP) data suggests world exports of computer and information services were US\$75b in 2003 and exports of other professional services US\$420b. (For these numbers see the survey by the WTO referenced at the end of this presentation.)

## Birth of a services sector giant?

### India's share of 'other' world commercial services exports

% of world total



Source: WTO International Trade Statistics database

While India's share of world *merchandise* trade is still below that achieved in the early 1960s, the country has seen a marked increase in its share of world *services* trade, with its overall share of world services exports tripling in about a decade. Gains have been concentrated in so-called new economy sectors like software, where India's share of the global market is around 17%, and where India's export growth has been double the world average. McKinsey estimates Indian firms now control over half the global IT & back office outsourcing market.

By 2003 India had roughly 2½% of the world market for 'other' commercial services exports, up from 0.4% in 1996. This is the category that captures communications, IT, financial, insurance and other business services.

As of 2004 total world commercial services exports stood at US\$2.1t, as against US\$9.1t for merchandise exports (so just under one-fifth of total exports). The 'other' category accounted for about 47% of total commercial services exports . . . or less than 8% of total world exports. But as we have noted already, there are major problems involved in accurately capturing services trade: much of across-border services trade within multinational firms (intra-firm trade) may not be recorded.

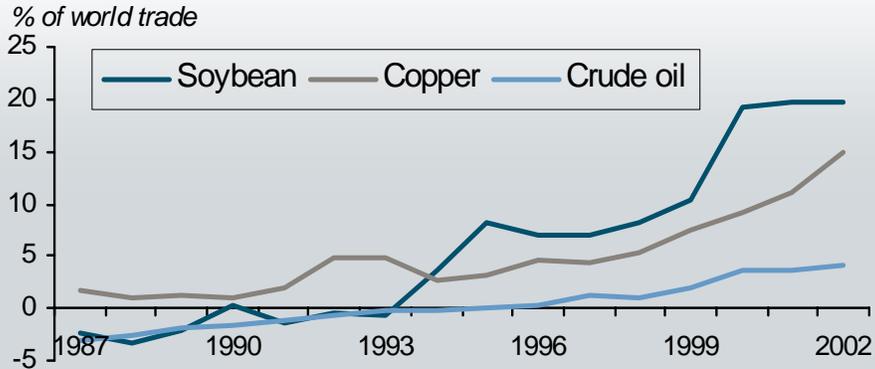
## **Powering growth: China, India and resources**

The influence of both China and India on world trade will not only be felt in terms of their export markets (where the impact will broadly be increased competition leading to downward pressure on prices / margins). Both the dragon and the elephant will also have growing appetites for raw materials and energy to fuel economic growth. On the import side of the equation, demand from the two Asian giants is likely to place *upward* pressure on prices.

Hence one key implication for international trade is for China and India to contribute to a shift in international *relative* prices.

## New sources of commodity demand

### China's net imports of selected commodities



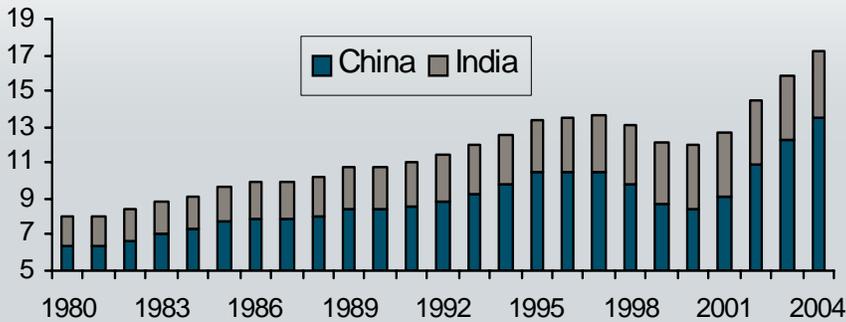
Source: IMF World Economic Outlook, 2004

Thus China is now the world's largest consumer and importer for several commodities, having displaced the US as the world's largest market for copper, iron ore, aluminium, and platinum. In the case of copper, for example, China's share of world trade had jumped from less than 1% in 1990 to 15% by 2003.

## A growing energy requirement

### World primary energy consumption

*% of total*



Source: BHP Statistical Review of World Energy June 2005

Energy markets are a big part of this story. China is already the second largest consumer of energy in the world (after the United States), while India has moved into fifth place. Between them the two economies accounted for almost one-fifth of total global primary energy consumption in 2004.

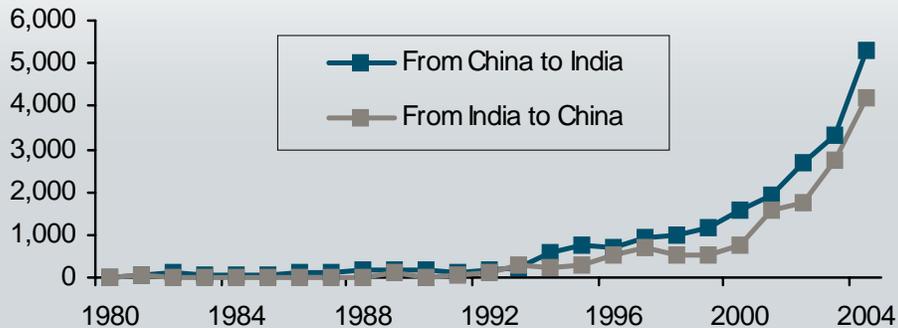
One specific energy market where their presence is already being felt is oil, where China in particular has had a major impact on price: Chinese demand has doubled over the past decade, with China overtaking Japan to be the world's second largest oil consumer in 2003. In 2004 China contributed to around one-third of the global increase in oil consumption – which increased at its fastest rate since the 1980s – which in turn contributed to significant upward pressure on oil prices.

## **Some policy implications**

## Competition, convergence, cooperation?

### China-India bilateral export trade

US\$ millions



Source: IMF Direction of Trade Statistics June 2005

Comparisons of China and India often evoke discussions of strategic competition; after all, the two countries fought a border war in 1962. And to some extent that sense of competition has probably acted as a spur to the Indian reform process. Still, recent years have also brought efforts at reworking the political relationship.

On the trade/economic front, until recently there was something of a sense on the Indian side that China was more of a threat than an opportunity, while on the Chinese side the view was that Beijing had nothing to learn from the Indian economic model. Yet both of those perceptions have now changed, and bilateral trade between the two economies has started to increase rapidly (albeit from a low base). There is also growing two-way investment (again from a very low base).

(Note that the bilateral trade data are inconsistent, with the DOTs China data showing China running a bilateral deficit with India in 2004, and the DOTs India data showing China running a bilateral surplus in the same year).

There has even been – so far purely theoretical – discussion about the potential ability of the two economies to cooperate (for example by coordinating purchasing orders) to maximise their economic leverage. At the same time, there has also been much discussion about the two being future *competitors* for strategic resources.

Finally, its also worth noting that the export models of China and India are likely to demonstrate some convergence in coming years – with India's presence in global manufacturing and China's in international services both likely to rise.

## Implications for policymakers

- **A profound shift in the geography of the global economy.**
- **Pressure for change in the international economic architecture.**
- **A boost to global trade . . . and world growth . . . But:**
- **Challenges to the development models of other emerging markets.**
- **Challenges for economic policy in the developed world.**

I'd like to finish with a few thoughts on what some of the policy implications of all this might be.

Perhaps the most obvious starting point is that the growing economic weight of China and India will produce a profound shift in the economic geography of the international economy, tilting the centre of economic activity back towards Asia from whence it departed in the nineteenth century.

This will have consequences for the international economic architecture. Bodies such as the G7 will either have to expand their membership to include the new economic powers, or give way to those like the G20 which already include them. The voices of Beijing and New Delhi are likely to be steadily more important in the deliberations of the international institutions that try to manage the global economy, including the WTO. Moreover, the two economies are likely to shape the international environment through new initiatives such as the preferential trade agreements that are currently spreading across Asia.

Economic success in China and India should be good news for global trade and growth. Indeed, China has already become an important determinant of international growth prospects in recent years (between 2001-2003 China accounted for about one-quarter of world growth measured at PPP rates).

The scale of these two new economic heavyweights will imply significant transition issues for the rest of the world.

contd.

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contd.

The resulting adjustment pressures could include downward wage pressure (and if macro policy is mismanaged, job loss?) in 'old' developing countries and in developed economies, set against gains in China and India. They will also raise questions about where countries fit into what will become a new international division of labour.

For economic pessimists / populists, the prospect of China as hub for labour-intensive, low-cost commodity manufacturing, but also for high-tech manufacturing, and India as a growing supplier of white-collar services (Microsoft now has research centres in Bangalore and Beijing, as well as Cambridge and the US) is ringing alarm bells. There have already been calls for a re-think of trade policy along with claims that 'old' trade theory is no longer relevant. Hence another policy challenge will be to deal with a possible resurgence in protectionist pressures in order to maintain the benefits of the new global economy, while also managing the adjustment strains in national economies.