The Indian EXPRESS COLUMNISTS

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Friday , February 20, 2004

for the record

‘Other’ superpowers rising

Heraclitus once said that ‘‘nothing endures but changes’’ and this is especially so in the global economy. The centre of world economic gravity is moving east and south. The most recent World Economic Outlook (WEO) projects a world growth rate of about 4.1 per cent for 2004, while developing countries are expected to grow, on average, at 5.6 per cent.

Developing and transition Asia is a particularly high-growth region, with conservative estimates of 5.9 per cent growth in India and 7.5 per cent in China next year. Malaysia and Thailand are projected to grow at 5.3 per cent and 5.1 per cent respectively in 2004. Actual growth rates both in India and China have been way above the projections of the world economic outlook with India in the current year poised to register 8 per cent rate of growth and China growing at a somewhat faster rate. Vietnam is expected to grow by 7 per cent, while Bangladesh, another contributor to high Asia-region growth, is predicted to have a growth rate of 5.8 per cent.

The recent Global Economic Prospects (GEP) predicts mixed growth performance in Latin America next year, but the longer-range expectations for large economies such as Brazil are more optimistic. Africa will also gain momentum. The WEO predicts an average growth rate of 5.6 per cent in 2004, though Sub-Saharan Africa is expected to be lower at 4.8 per cent.

Europe, in contrast, seems to be losing momentum, with adverse consequences for Eastern and Central European trading partners. A recent IMF report argues that United States’ growing deficit is a potential threat to the world economy. Overall, the predicted growth rate in the advanced economies, at 2.9 per cent, is substantially below the expected world average. And the future presents an even more marked shift: Brazil, Russia, India and China, could have larger economies, in US dollar terms, than the G6 nations within 40 years. How will this new ‘‘centre of gravity’’ affect the world economy? In simple terms, the dynamism of the Asian region cannot help but spill over to boost more general growth in the world economy. It seems clear that the trade transmission channel — in which fast-growing markets boost other nations’ growth by acting as absorbers of exports — is only part of the way in which the new Asian economic powers will interact with the rest of the world. Growth in the transition and developing Asian countries will also provide a source of high returns on investments, spilling over to increase incomes in slower-growing regions.

The new centre of gravity will perhaps bring some stabilising forces. One interesting possibility, suggests that Asia’s and other emerging markets’ growth strategies will support wider growth in the world economy by continuing to finance the United States’ deficit. It has been suggested that Asian countries’ export-led growth strategies implies that exporting to the US is a key policy goal. The governments of these countries are thus willing to finance these exports by buying US securities if imports from the US fall short. By their reasoning, this makes official creditors in Asia more willing to continue lending to the US even as the deficit grows and creditors who were solely interested in returns on their investments might demand a higher risk premium.

While this might indeed be one aspect of the new international economy, I am somewhat skeptical of its sustainability. Recent analysis by Michael Dooley and others see no immediate end to this arrangement. They anticipate (quite correctly) that Asia and other emerging economies have enough unrealised growth capacity to continue playing a large role in financing the US deficit. But they assume (possibly incorrectly) that these countries will continue to be single-mindedly interested in exporting to the US to the point that their governments will continue to be willing to hold US securities without demanding compensation for the additional risk due to growing deficits.

The benefits of exporting to the US are decreasing, while the costs increasing; at some point the periphery will not finance the centre. More importantly for our discussion, however, is the new gravitational force of large, under-utilised labour pools in the new centres of gravity. Adjusting to the inevitable change in the location of economic activity and transformation of industry within all globally integrated countries will be the biggest challenge we face. India and China's population are the largest in the world, with Brazil, Indonesia, Pakistan and other developing countries not far behind. The US and Japan are the only two industrial countries among the top 10 most populous nations.

Upcoming demographic changes reinforce this ''Eastern Centre of Gravity''. The median age of the population in OECD countries is rising rapidly. The United States' labour force is expected to drop by 17 million workers by 2020, and Japan's workforce by 9 million over the same period. European demographics show a similar trend: France, Spain, and Germany, for example, are each expected to have 3 million less workers in the labour force in the next two decades. India, by contrast is expected to have 47 million more workers by 2020 and Pakistan is expected to have 19 million more. China and Russia's demographics follow the OECD pattern of upcoming reductions in the labour force, but most other developing and transition countries see labour force expansions.

The sheer numbers of workers alone already exert a powerful attraction for low-skill manufacturing kinds of industries. As the skill base improves, however, more and more businesses are outsourcing call centres, back-office operations, as well as more sophisticated tasks like software creation and research and development. An accountant in the US costs $5000 a month, while one in India or Ireland costs US$ 300. A chip designer in China, at a wage of $1000 a month, looks extremely appealing next to her $7000-a-month in the US. Aerospace engineers in the Philippines cost little more than a 1/10th of the cost of aerospace engineers in the US (US$ 650 compared to $6000).

The relatively new phenomenon of clients going to where the service providers are is a second aspect of this shift in the location of economic activity. The increasing number of OECD patients seeking medical treatment and attention in India, Thailand, and other Asian countries is a precursor of wider changes in other sectors. ''Nothing endures but change'' in this kind of economy. The constant search for lower labour costs is already ''hollowing out'' manufacturing in many industrial countries. This phenomenon is not confined to the industrial countries.

Take Mexico's experience, for example. The maquiladora industry — essentially outsourcing of US firms' lower-skilled manufacturing — was the top generator of hard currency in the late 1990s. More than a million workers were employed in foreign-owned plants in 2002 and 700 of the US Fortune 1000 companies had affiliates, components production, or some portion of their operations in Mexico during the same year. As workers' skills have improved, however, so has their productivity. With rising productivity came rising wages. Rising wages, in turn, prompted US firms to seek lower-wage workers for the least skilled manufacturing jobs. And many maquiladora jobs moved to China and India.

Looking a decade or two forward, labour migration will be an additional aspect of the reallocation of economic activity. The International Labour Organisation (ILO) estimated that nearly 50 million foreign workers were already contributing to the European and US economies in 2002. While manufacturing and some services can be traded across countries, many other essential services cannot be. There is growing recognition that industrial countries' ageing work forces will have to be supplemented, inevitably by skilled and unskilled migrants from Asia and other emerging markets. There are several key factors in adjusting to this new global labour market. First, is to increase funding for worker training to help them move higher up the manufacturing chain toward more skilled jobs. Sustainable expansion of jobs in the OECD depends on taking advantage of the education infrastructure to make sure that workers are ready for higher-value-added jobs as lower-skilled jobs continue to be pulled toward the new centres of gravity.

Second, financial markets must be ready to facilitate these labour-driven changes in the location of economic activities. Industrial countries should divert more funding into research and development to support the high-skilled industries that are these economies' comparative advantage. The priority for developing countries is flexibility, as these will be the nations climbing the skills ladder the most quickly. Increasing financing for small and medium enterprises that can adjust to changing trends comparatively rapidly is one place to start.

Third, flexible immigration policies will be an important contributor to global growth. Migration has obvious benefits for sender countries — worker remittances have never been higher. The receiving countries benefit as well from lower labour costs, enhanced productivity, and a fresh flow of ideas. These benefits will be all the more important as the OECD countries' dependency ratios increase and the costs of health care for aging populations rise.

The United Nations' recently launched Global Commission on International Migration is one symbol of an international commitment to developing a framework for migration, but much of the impetus is on national policymakers. The US' reaction to increased outsourcing and rising migration (illegal and legal) is exactly the way not to adjust. Reduced visa quotas, particularly the H-1B visas reserved for highly skilled workers are hurting many companies in Silicon Valley . Various states' bills preventing outsourcing of government practices are handicapping efforts to maintain the quality of social services while limiting growing budget deficits.

Finally, the markets emerging as the new centre of gravity also have their own set of adjustments to make. Weak protection for intellectual property rights still create a deterrent to foreign investment and outsourcing, particularly in easy-to-replicate sectors such as pharmaceutical and technology components. However, the world would need to increasingly adjust to a new economic order with new centres of gravity. The preponderence of evidence and emerging trends inescapably point in this direction. This will only be reinforced by the negative ways in which the emerging trends is being handled by the present centers of economic power.

Whether it be the negatives or the positives, the centre of economic gravity is certainly shifting and must adjust to the new realities.

The Planning Commission member spoke at INSEAD, Fontainebleau, France on January 28