



Eclipse: Living in the Shadow of China's Economic Dominance

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September 23, 2011



Motivation

- **Convergence big time, for the first time**

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	1870-1960	1960-2000	2000-2008
Number of developing countries converging	2	21	76
Percent of countries converging	5%	29%	85%
Magnitude of convergence	0.02%	1.53%	3.01%



Motivation

- **Convergence**
- **Central American belief**
 - **“When the Soviet Union collapsed instead, the *Harvard Business Review* in 1990 proclaimed in every issue—every issue—in one way or another that the Cold War was over and that Germany and Japan had won. Now we hear the same thing with respect to China. Predictions of America’s decline are as old as the republic.” (Summers, 2010)**



Main Messages

- **China's economic dominance is more imminent, larger in magnitude, and broader in scope than currently believed**
- **The rise of the RMB is conditionally imminent**
- **The current open economic system will likely survive China's dominance but the world needs multilateralism as insurance**
- **America might be vulnerable. Repeat of Suez-type episode is low probability but enough parallels to warrant concern**



Index of Economic Dominance

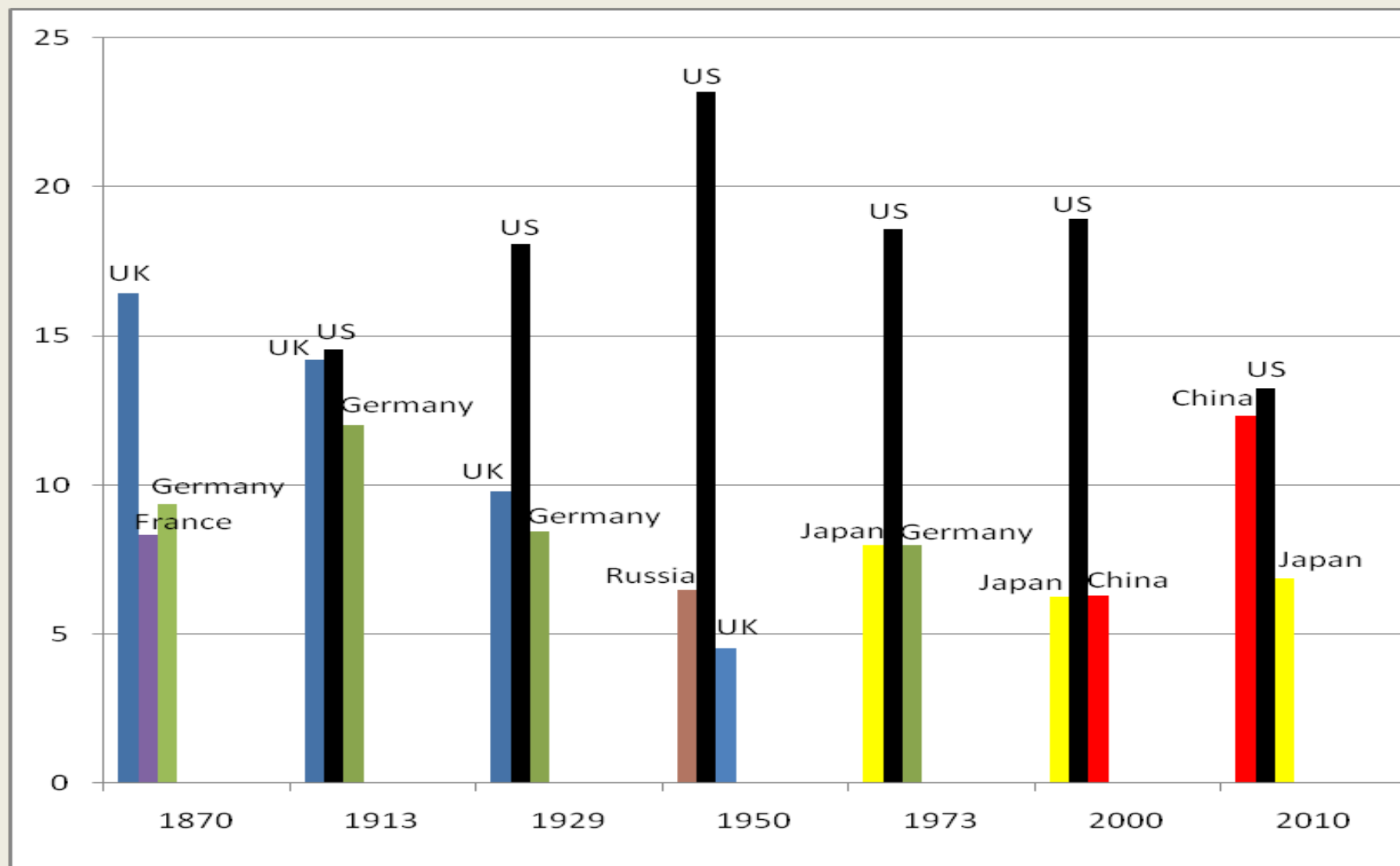
- **Economic attributes that confer the ability to change actions of others and to preserve own freedom to act**
- **Quantifying dominance**
 - Conceptually problematic
 - Pitfalls of implementation
- **Key determinants:**
 - GDP (resources for power),
 - Trade (power of market access)
 - External financial strength (“Insolvents Must Fawn”)



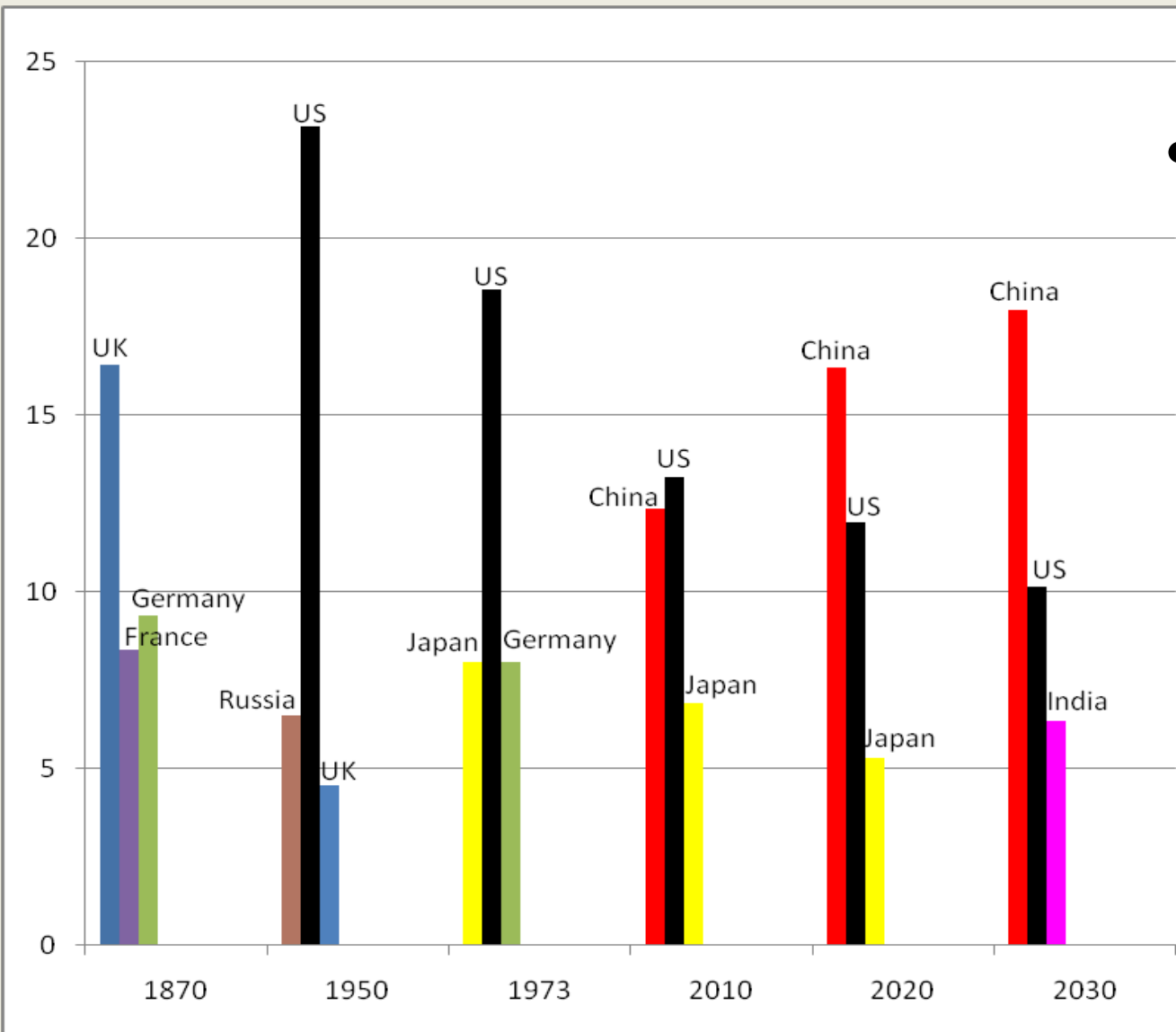
Index of Economic Dominance (contd.)

- **Other determinants? Fiscal strength, military strength, reserve currency status**
- **Measurement: Share in world total**
 - GDP (PPP and Dollar equally weighted)
 - Trade (exports plus imports)
 - External financial strength (cumulative current account balance)
- **Weighting: IMF and reserve currency**
- **Validation**
- **Projecting dominance: The centrality and plausibility of growth assumptions**
 - **US: 2.5 percent (5.5 per capita, PPP)**
 - **China: 6.9 percent (1.7 per capita, PPP)**

More imminent ...



Greater in magnitude ...



- Combination of demography, convergence, and gravity (and of course uphill flows of capital (mercantilism))



And broader in scope

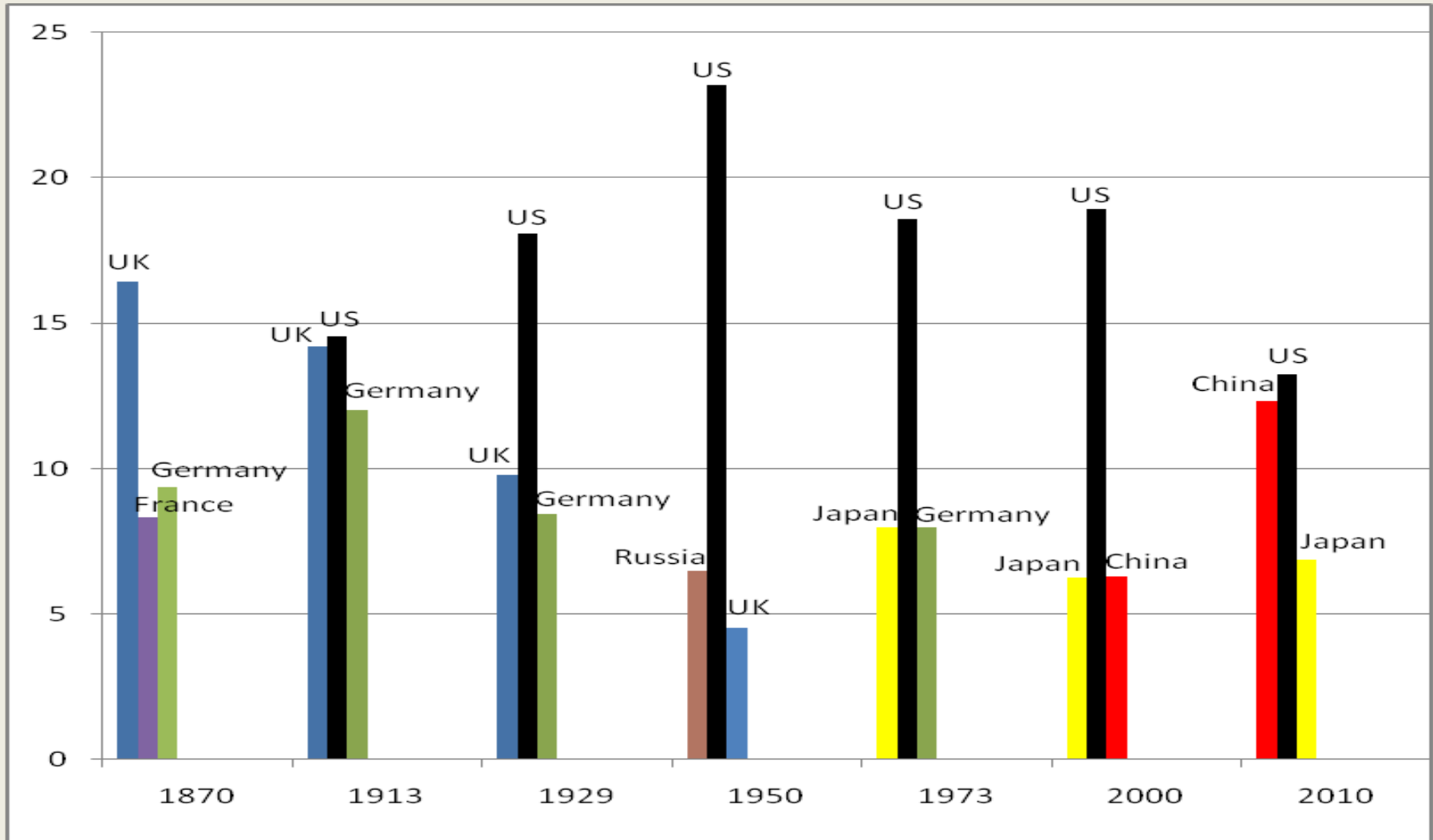
- **RMB will be premier reserve currency in the next ten years or soon thereafter”**
- **Of course, it will depend on many changes:**
 - market-determined interest rates
 - market-determined exchange rates
 - deep and liquid financial markets
- **Of course, these changes will be politically difficult because vested interests around status quo**
 - Tradable goods sectors/Ministry of Commerce
 - Domestic financial system
- **But ...**



Renminbi's rise (contd.)

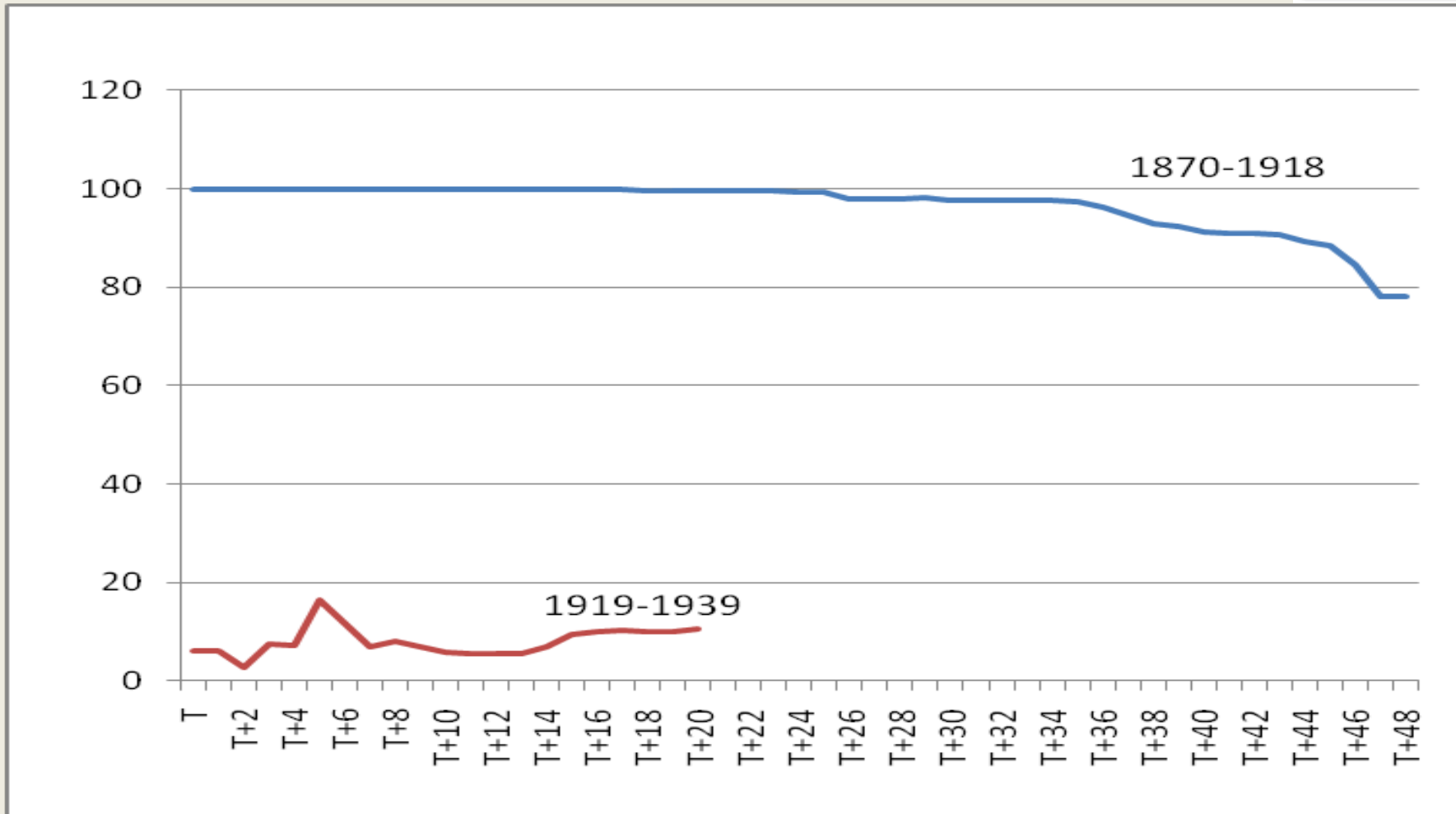
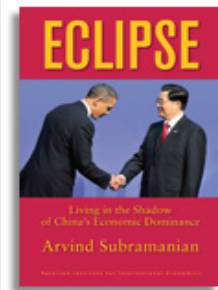
- **Broader dominance perspective forces re-interpretation of history**
 - **Lag between dollar's rise and dominance of the US economy 10 not 60 years**

US became economically dominant later from a dominance perspective



Dollar became dominant earlier than believed

(Share of sterling relative to dollars in bond issuance by Argentina, Brazil and Chile, 1870-1939)

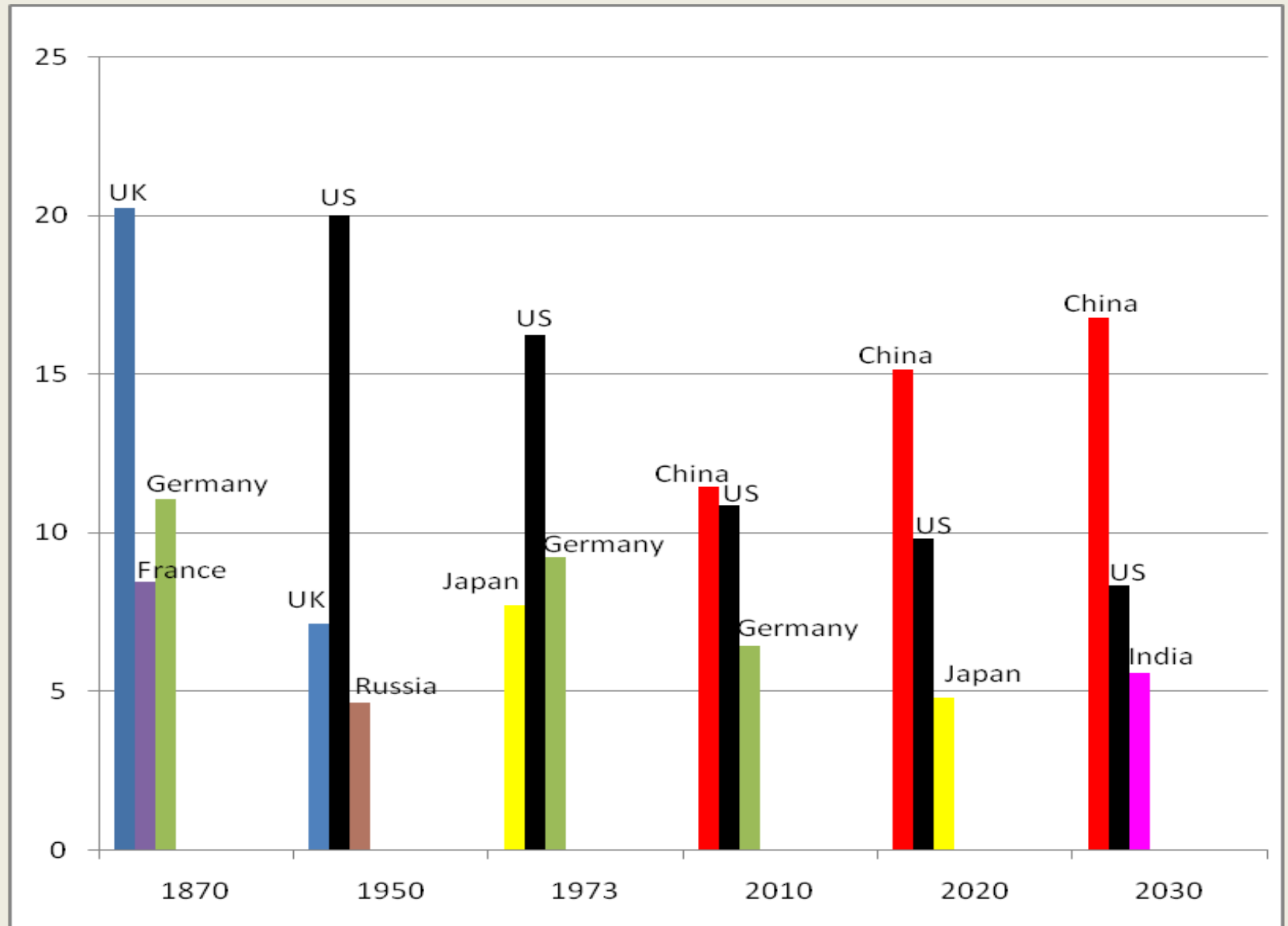




Renminbi's rise (contd.)

- **Broader dominance perspective forces re-interpretation of history**
 - Lag between dollar's rise and dominance of the US economy 10 not 60 years
- **RMB internationalization shows there are countervailing forces**
 - Reduce vulnerability of export dependence ; burden of reserve accumulation
- **RMB internationalization offers a plausible political economy exit from mercantilist status quo**
 - Symbolic gains to offset the opposition from vested interests
- **Skeptics are essentially living in/extrapolating the present**

Dominance in 2020



Will the open economic system survive China's dominance?

- **Delivering convergence is critical for China's policy makers**
- **China's convergence process is far from finished**
- **China's convergence has relied and will continue to rely on trade**
- **China's need for an open system is an existential economic necessity unlike for the US after World War II**
- **In addition, China is becoming hub of "criss-crossing globalization"**

A trading superpower

Trade patterns of economically dominant powers	
	Percent overtrading (+) /undertrading (-)
<i>United Kingdom: 1870</i>	
Exports	84.0
<i>United States: 1975</i>	
Total trade	-45.3
<i>China: 2008</i>	
Total trade	68.6



But tail risk

- **History's counsel is we cannot be sure**
- **And China's actions (for example, exchange rate) gives rise to doubt and China's systemic vision remains unarticulated and unclear**
- **Multilateralism offers insurance, namely, protection against the strong exercising unbenign hegemony**
 - **US not always benign hegemon**
- **Multilateralism to prevent harm: If China's protects or undervalues, need the collective heft of others (i.e. multilateralism) to secure change: Even US can no longer do it alone**
- **Alternatives: Promiscuous bilateralism and hostile bilateralism**
- **Multilateralism to do good: China finances Europe or others through IMF rather than bilaterally**



Final thoughts: America

- **Is a repeat of Suez/US-borrowing-from-IMF possible?**
- **Obvious differences:**
 - **Why would China sell dollars and act against its own currency strategy?**
 - **US does not need to fear dollar decline like the UK did in 1956**
- **Deeper parallel: generalized economic weakness plus the emergence of a credible rival**

<http://www.piie.com/eclipse.cfm>

