

Gloomy view exposes power dilemma

The author rips into widespread fears about changes to the balance of world power by focusing on the immaturity of many emerging countries. But he does not make the case for America either.

Revelations that China fields its own stealth bomber, and that educational attainment levels in Shanghai are soaring above those in America, stoke western anxieties about the decline of America as a superpower.

Even though America's \$729 billion (£459 billion) military budget is more than nine times that of China's, the media is more interested in the Asian dragon flexing its muscles, and whether this is a sign of things to come. Likewise, China still lags America in educational attainment but that did not stop Barack Obama declaring that America had reached a "Sputnik moment" – a phrase used again in his State of the Union address, which called on Americans to "win the future" back from China.

It is this anxiety the book by George Magnus, a senior economic adviser at UBS Investment Bank, seeks to temper. The author exposes the frailties of emerging markets and questions the euphoria and fear they provoke. Should America be written off just yet? Magnus says not. Emerging economies, he says, while bold and dynamic are also young and susceptible to overconfidence, as shown by the crises that hit America in the 1920s, Japan in the 1980s, and a host of Asian Tiger economies in the 1990s.

First on the author's hit list is the tendency among economists to overstate emerging market success by focusing on GDP and ignoring markers like income per head. He particularly criticises the GDP add-on purchasing power parity (PPP), which accounts for price differentials in emerging markets but exaggerates the contribution a country makes to the world economy – in China's case inflating total GDP from \$4 trillion to

\$9 trillion. Prices are lower in emerging markets because they are poor, Magnus reminds us, and they will rise as they become richer. PPP is also behind most assertions that emerging markets will overtake their developed counterparts by the 2020s.

Instead, Magnus suggests a broader set of goals that nations should meet to shed their emerging tag. These include full integration into globalisation; the smooth channelling of savings into wealth creation for the public; good governance in the form of rule of law; capacity to handle demographic change; reasonable public and private sector deficits; and the nurturing of technology and a knowledge-based economy.

Touching on various G20 countries, but using China as his main model, he shows how most emerging markets lack in some, if not all, of these areas and may do for generations.

An example is China's current trade surplus with America, which may be less a global symbol of financial power than a seed of financial instability. With an economy largely dependent on exports to America, and not enough domestic consumption to reverse this, China has little choice but to continue trading in the dollar and ploughing its profits back into American assets. While an undervalued renminbi gives it the upper hand in the two countries' dealings, any shocks

to the dollar caused by a trade war will mar its success story.

The solutions to such problems lie in good political governance, argues Magnus. He highlights the different fortunes of Argentina and Brazil. While the former failed to reform and became a financial pariah, the latter instilled financial discipline in the 1990s and went on to join the select club of large emerging economies – not the outcome many would have expected during its bout of 2,900% hyperinflation in 1990.

For a country like China, of course, reform is a stickier issue, and while the author avoids moralising about democracy, he suggests the country's lack of independent judiciary, and a financial market open to all, will seriously inhibit its growth and even lead to political instability.

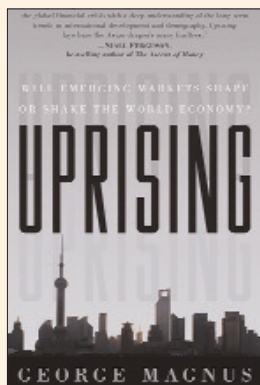
Magnus points to demography, arguing it is not just developed countries that will face upheaval. India's rise to 10% annual growth is often predicated on the young working age population it will have over the next two decades. However, its unproductive agricultural and manufacturing sectors may not be able to absorb the 200m people expected to enter the job market during that period.

China meanwhile, is the fastest ageing emerging economy, with a median age of 45 – just a year younger than that of America – something that will slow productivity and cost money. All emerging markets will see their population growth slow as they get richer. In addition, the strains of energy and water shortages, not to mention climate change – all of which will have a greater impact on hotter, drier emerging nations – and such countries may compare quite differently to forecasts by the

George Magnus Uprising

Will Emerging Markets
Shape or Shake the
World Economy?

Wiley, November 2010



mid 21st century

These are just educated guesses, and there is the sense that Magnus's pessimism, while offering a useful counterpoint, also serves a rather traditionalist point. After the shock of the financial crisis, the rise in protectionism has been destructive for both emerging and western economies. Yet in the short term it is the latter that cannot recover without the help of the former. Magnus eloquently calls for greater regulation in the form of a new Bretton Woods-style system, in which nations work together to address the threats built into the financial system. But he sounds less convincing when positing America as the leader of this new world order.

After all, while Uprising extensively documents the weaknesses of China, it offers little about America's bigger and brighter ideas. Magnus argues that a politically regressive China should not have global sway. But at the moment the People's Republic seems uninterested in the job, and may well be a democracy by 2030 anyway. Similarly, while Magnus is right to highlight the immaturity of emerging markets, it is hard to see how a matured American economy can inspire confidence after the collapse of its buyer-borrower model. A \$14 trillion economy is impressive, but one with such a heavy public debt burden much less so.

REVIEW



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