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Publication

POLICY PERSPECTIVES
Vol. 18 No. 1 – February 2011 Editor: Jock A. Finlayson

A NEW WORLD ORDER TAKES SHAPE

How long before a surging China eclipses a struggling United States as the largest national economy? The question takes on new significance as the world continues to recover from the 2008-09 financial crisis and economic downturn.

Prior to 2007, most prognosticators were confident the US would remain number one in the global pecking order – as measured by the value of total economic output – until 2040 or later. Today, forecasters are hurriedly revising their projections in light of the global recession's markedly divergent impacts on emerging and advanced economies. The result is that the US now looks to be on track to cede the top spot to China much sooner than anticipated even five years ago – around 2020, according to a number of recent forecasts.

Changing Patterns of Global Economic Influence

A new report from the UK economics group at PricewaterhouseCoopers is an example of how the 2008-09 financial crisis and recession have served to speed up the transition to a new global balance of power.[1] The report builds on and updates previous PWC projections published in 2006 and 2008. The authors' principal finding:

> "Our key conclusion is that the global financial crisis has further accelerated the shift in global economic power to the emerging economies."[2]

Specifically, the PWC analysts estimate that by 2020, the biggest seven emerging market economies together will have overtaken the G7 countries in collective economic output (GDP), measured using purchasing power parity exchange rates.[3] Also by 2020, China will have surpassed the United States on the same measure. Purchasing power parity (PPP) exchange rates differ from market exchange rates in that they adjust for price level differences among countries, and thereby provide a more accurate gauge of average living standards.

Table 1 below shows PWC's projections for the world's ten largest economies in 2009 and in 2050, where GDP is calibrated in real 2009 US dollars, and the GDP of countries other than the United States is measured relative to the US using purchasing power parity (PPP)

[1] PWC, The World in 2050 (January 2011). Available at: www.pwc.uk/economics
[2] Ibid., p. 3.
[3] The G7 economies are the US, Japan, Germany, the UK, France, Italy and Canada. As of 2009, the seven biggest emerging market economies, based on GDP at purchasing power parity exchange rates, were China, India, Russia, Brazil, Mexico, South Korea, and Turkey.

exchange rates. The most striking changes by 2050 are that China and India are ranked number one and two, respectively, in aggregate GDP, while Brazil jumps to 4th spot. Emerging market economies occupy six of the top ten positions. European countries are destined to lose significant relative economic clout; by 2050, Mexico and Indonesia will have overtaken Germany and the UK, for example. Of interest, Canada drops only two notches according to the PWC forecast, slipping from the 14th to the 16th largest national economy on a PPP basis.[4]

Table 1
Ten Biggest Economies
(US$ GDP, billions)*

2009		2050	
US	14,256	China	59, 475
China	8,888	India	43,180
Japan	4,138	US	37,876
India	4,752	Brazil	9,762
Germany	2,984	Japan	7,664
Russia	2,687	Russia	7,559
UK	2,257	Mexico	6,682
France	2,172	Indonesia	6,205
Brazil	2,020	Germany	5,707
Italy	1,922	UK	5,628

* Measured in constant 2009 US dollars, at purchasing power parity exchange rates.
Source: PWC, The World in 2050 (2011).

Table 2 repeats the ranking exercise summarized in Table 1, but in this case the GDP of countries other than the United States is calibrated using **market exchange rates** (MERs) instead of PPP rates. Market exchange rates provide a better measure of the relative size of national economies for business planning purposes, at least in the short-term. However, over time, as their economies continue to develop, many emerging markets should see a rise in their real exchange rates toward their PPP rates. This will occur as a result of: i) higher price inflation and rising wages in many developing countries, ii) nominal exchange rate appreciation in these countries, or iii) a combination of both effects.[5]

Table 2
Ten Biggest Economies
– GDP at MER rankings
(US$ GDP, billions)*

2009			2050	
US	14,256		China	51,180
Japan	5,068		US	37,876
China	4,909		India	31,313
Germany	3,347		Brazil	9,235
France	2,649		Japan	7,664
UK	2,175		Russia	6,112
Italy	2,113		Mexico	5,800
Brazil	1,572		Germany	5,707
Spain	1,460		UK	5,628
Canada	1,336		Indonesia	5,358
		(15th)	Canada	3,322

* Measured in constant 2009 US dollars
Source: World Bank estimates for 2009, PWC model estimates for 2050.

4 This highlights the fact that even though Canada is a member of the G7 group of advanced economies, strictly speaking our economy is too small to warrant inclusion in this rich countries' club. According to PWC's estimates, Spain should replace Canada in the G7.

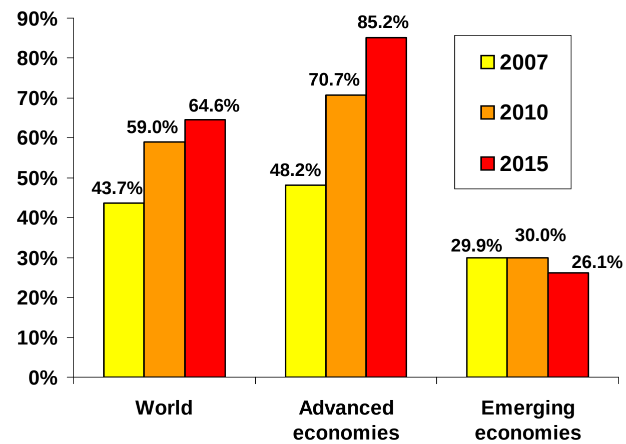
5 The World in 2050, *op cit*., p. 6.

In Table 2, China still ends up with the biggest national economy by 2050, but the United States manages to hold on to second spot (barely), followed by India and Brazil. Again, six of ten biggest national economies by 2050 are emerging markets. Using market exchange rates, Canada was the world's 10th largest economy in 2009, but it drops to 15th by 2050.

Divergent Fiscal Trends

Not only did China, India, Brazil and a number of other key emerging market economies avoid falling into technical recessions in 2008-09, but they have come out of the crisis with notably strong fundamentals, particularly in the area of public finances. Indeed, based on work done by Eswar Prasad and his colleagues at the Brookings Institution, and as summarized in Figure 1 below, emerging economies as a group are expected to see their pubic sector debt loads decline as a share of gross domestic product, going from 30 percent in 2007 to 26 percent by 2015.[6] Over the same period, the advanced economies as a group are projected to suffer a rapid-fire run-up in accumulated government debt – from 48 percent to 85 percent of their collective GDP.

Figure 1
Net Government Debt to GDP



Source: Brookings Institution.

The contrast could hardly be starker, and it points to a new and surprising source of competitive advantage for many developing countries in the years ahead. As Professor Prasad and his co-author conclude:

"Our analysis paints a sobering picture of worsening public debt dynamics and a sharply rising debt burden in [advanced economies]. First, as a group [advanced economies] are experiencing little population growth. Second, they are facing rapidly aging populations. Third, their economies are likely to register slow growth…relative to the [emerging markets]. Fourth, entitlement spending on health care and pensions is likely to explode [in many advanced economies] due to unfavorable demographics."

Although Canada is somewhat better off than most other advanced countries in underlying fiscal strength, owing to a faster-growing population and a lower level of government debt relative to GDP, Canada is less favourably positioned when compared to many of the leading emerging economies.

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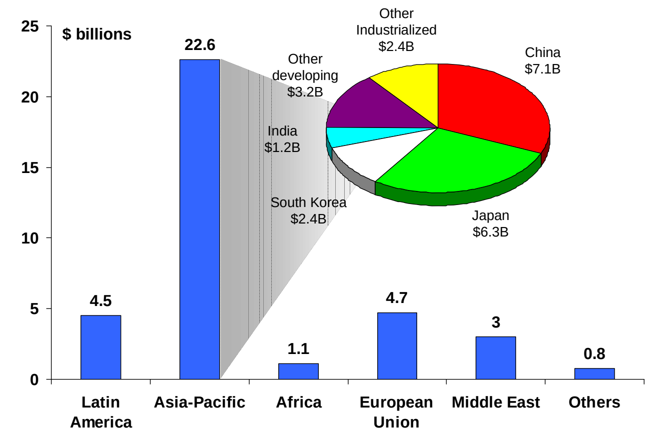
[6] Eswar Prasad and M. Ding, "The Rising Burden of Government Debt," Brookings Institution (November 1, 2010). Available at: www.brookings.edu/articles/2010/1101_government_debt_prasad.aspx?p=1

Implications for Western Canada

The global rise of China, India and other emerging markets carries important implications for British Columbia and the other Western Canadian provinces. As a whole, the West's international comparative advantages lie mainly in resource-based sectors – agri-food, energy, minerals, metals, and forest products. In addition, the West is home to a number of tradable knowledge-based service industries such as engineering, education, professional, scientific and technical services, and environmental management and remediation. World demand is increasing steadily for many of these resource goods and sophisticated services, driven by robust economic growth in the emerging nations of Asia, Latin America, and elsewhere.

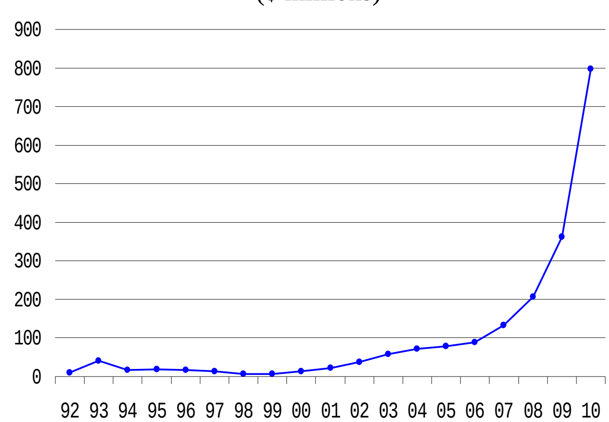
Figure 2
Western Canadian Exports to Non-US Destinations (2009)



Source: Canada West Foundation.

Western Canada already exports $23 billion in goods to Asia-Pacific destinations (see Figure 2), representing three-fifths of the region's overall non-US export shipments. In dollar terms, the West accounts for two-thirds of Canada's exports to the Asia-Pacific.[7]

Figure 3
BC Wood Product Exports to China
($ millions)



Source: Statistics Canada.

British Columbia's experience in selling wood products to China is a dramatic example of how new sources of demand in emerging economies can work to the advantage of Western Canada. Over the past decade, BC lumber exports to China have exploded, going from virtually nothing to almost $800 million by 2010 (Figure 3). Some industry analysts believe that China will actually surpass the US as the number one market for BC wood products within a few years. Looking ahead, sustained growth and the development of larger middle-income populations in a significant number of emerging economies should continue to foster exciting trade and other commercial opportunities for industries in BC and the rest of Canada.

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[7] Canada West Foundation, Trade with China, India and Other Asia-Pacific Markets and Economic Diversification in Western Canada (February 2011), p. 11. The cited export figures refer to merchandise (goods) exports only; comparable data on services exports is not available.

Conclusion

The PWC projections discussed above, like those produced by other think tanks and forecasting groups, assume that China, India, Brazil and other emerging markets will continue to post strong economic growth going forward, while the major advanced countries limp along with growth in the vicinity of two percent (or less) per year. While by no means far-fetched, these assumptions are open to criticism, and they certainly won't be accepted by all analysts. Moreover, in terms of income per person, which is the best gauge of a nation's prosperity, it is important to recognize that most emerging market economies will continue to lag far behind the leading developed countries for many decades to come.

However, even if one adopts slightly different assumptions about future patterns of economic growth across the advanced and emerging economies, the basic message doesn't change very much. China, India, Brazil, and other emerging markets are indisputably on the rise, while the mature developed countries strive to cope with aging (and in cases like Japan shrinking) populations, ballooning government debts, and lower potential growth rates. Within five years, emerging markets are expected to account for half of global production, and for 45-50 percent of international trade, proportions that will then increase further post-2020.

In short, we are on the cusp of a new world order, as economic, financial and ultimately political power inexorably bleeds away from the West and the North to the nations of the East and the South.

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