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In many ways, the title of this talk, *The New World Turned Upside Down*, is a strange one. For most of human history the centre of gravity of the world economy was in areas we now call, in rather patronising terms, “emerging”. European ships went East because that was where the wealth was – be it in spices, cotton, porcelain or silk and the rest of it. Nevertheless, the rapid development of China and India is a remarkable phenomenon. In a matter of one generation, China has broken through to a degree that took over a century in Britain. Solidly established precedents like South Korea show that this breakthrough can be sustained.

It is clear that major so-called emerging markets have already emerged. The question I’d like to touch upon today is about the consequences of re-emerging economies on the world economy.

The bigger emerging countries – China, India and probably Brazil – have achieved very substantial growth and reductions in poverty levels based largely on an expansion of their domestic market and domestic savings. Trade and foreign capital flows have not actually been central to their story, though nonetheless increasingly important for the rest of the world. Domestic consumption and investment growth have spilled over into growing import demand for commodities.

For many commodities, China is now the biggest source of incremental demand in world markets. The impact of the rapid growth of these economies, especially China and India, has pushed up demand faster than supply resulting in the oil and

wider commodity price shock of 2007/08. Rapid export growth, especially for China, has also supplied the world with cheap manufactured goods, helping to create a non-inflationary environment which made it possible for the US, the UK and other Western countries to grow rapidly, without triggering overt inflation, over the last decade.

While cheap goods created the conditions for low inflation and low short-term interest rates, the vast accumulation of – mainly – Chinese foreign exchange earnings manifested itself in the purchase of US government bonds, keeping down long-term interest rates, further fuelling the recent boom that we experienced.

There was also a large accumulation of current account surpluses, and these translated into large foreign exchange reserves which, combined with the surpluses and reserves of raw material exporters, created a vast pool of liquidity which has flowed back into Western economies.

In historical terms, this pattern of capital flow was unusual. Normally the most developed economies have had a surplus of savings over investment and exported capital to the “developing” world. Now the reverse has been happening, at least in relation to China on the one hand, and the US/UK on the other.

The available liquidity and cheap capital provided the fuel for a credit boom and the massive expansion of financial markets, and drove up asset prices, especially in housing, to unsustainable levels: hence, in due course, the crash. It is pointless to start pointing fingers and attribute blame. In the long boom we were only too happy to be carried along by Chinese excess savings. The simple point is that, as with commodity markets, the big emerging economies already have a major impact on the world economy.

So it should not come as a surprise that China and India, two countries which each account for 20% of the world's population, will increasingly dominate the global economy. Two hundred years ago, according to Angus Maddison, who did brilliant work on old economic statistics, China accounted for around 35% of the world's population and almost 30% of world GDP, while India accounted for 20% of the world's population and 16% of GDP. Back then, incidentally, the US represented 1% of the population and 2% of GDP.

With India growing in recent years at around 7% a year, China at 9% and the Western world at 2-3% before the recession, it seems likely that, barring disaster, China will have a bigger economy than the USA well before 2040. By then, India will have an economy the size of Germany, Britain and France combined – with Brazil, Mexico and Russia also having an economy bigger than any European country.

These extrapolations are now widely recognized and are even more dramatic if current GDP is treated in purchasing power parity terms. I recall that during an exercise at Shell in the early 1990s, we did a scenario planning exercise called New Frontiers, which projected forward a world scenario to roundabout today in which both global energy demand and supply were being dependent on events in emerging markets rather than Europe and North America. At that time it was somewhat scary to those with a Euro-centric way of looking at the world. But it has happened. More recently, Stephen King of HSBC and others have helped us to understand the new world more clearly. And I tried to capture some of the dilemmas in my book 'The Storm.'

For its part, Western companies and governments have welcomed emerging market growth and viewed it as an investment and trade opportunity. Not only that, but by maintaining open markets we are helping to sustain rapid progress in alleviating poverty. Yet there are growing undercurrents of disquiet about

competition across a wide range of goods allegedly depressing wages and sapping the willingness and ability of governments to maintain open, liberalized economies.

The dilemma emerging is this. The free movement of goods, services, capital and, more controversially, people, has brought, and will bring, great economic benefits. But there are growing perceptions of, and some actual, conflicts of interest. To manage these and to maintain the momentum behind globalisation requires cooperative solutions – to manage disputes over trade and investment, environmental damage and mass migration, and much else.

But we knew that even in the good times, though, and between countries which saw themselves as allies, Governments struggled to agree. We now face more difficult economic conditions increasingly lead Western Governments to look inwards. Global agreements such as the Doha Round and the Copenhagen climate change negotiations have stalled or certainly not progressed as rapidly as we'd like. Those with a pessimistic turn of mind will recall that the delayed reaction to the 1929 Great Crash was Taft Hartley and protectionist tit-for-tat. That experience was not exactly encouraging.

The Coalition Government is absolutely clear that we should treat the shift in the centre of gravity in the world economy to emerging markets as an opportunity, not a threat. Our Coalition Agreement says: "We will work to intensify our cultural, educational, commercial and diplomatic links with many nations beyond Europe and North America to strengthen the UK's relations with the fastest-growing areas of the world economy." The UKTI that acts for my Department is very clearly focused on opportunities for these emerging economies.

HMGs commitment to improving relations with emerging markets has been backed by actions – PM led biggest British trade mission to India, George Osborne

has visited China and Korea, William Hague has been to Japan and Hong Kong, and I was also recently in Brazil, as well as India. We also warmly welcome the glut of inward investment from emerging economies by companies – and institutional investors including sovereign wealth funds. Companies from emerging markets like Tata and now the Thai steel company SSI are investing substantial amounts in the UK economy.

The UK Government is clear that a return to protectionism is not the way forward. Globalisation is not a zero-sum game. Economic nationalism at UK or European level will not help sustained recovery and will be counter-productive.

In particular, concluding Doha would safeguard against potential protectionism and send a signal that countries are capable of cooperating for the greater economic good. It could also herald a significant boost to the global economy, perhaps £110 billion annually.

Low income countries stand to gain particularly from reductions in agricultural trade barriers, which currently cost developing countries €15bn per year in agricultural income alone. It is estimated that the removal of cotton subsidies alone could increase cotton farmers' income by as much as 30% in sub-Saharan Africa.

But there are many competing pressures and negotiating a worthwhile global trade deal will be difficult. We know that there is resistance in the US Congress and parts of the EU and indeed there are sectoral interests in India and China too.

A lot is at stake. One of the lessons of the long period of global integration and expansion before World War One which transformed Britain into a developed, industrial economy is that we cannot just assume globalisation will continue. Without serious political commitment it will fall apart. That must not happen.

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