Ministry of Economic Affairs, Agriculture and Innovation

The Economic Balance of Power Shifts from West to East

CHINDIA RULES!

With ‘Chindia Rules!’, Felix Meritis, the European centre for arts, culture and science, organises a series of debates on the marked rise of China and India, and the transition to a new world order. The first meeting with an international audience will be on 25 October 2011 in Amsterdam.

With this discussion paper on the shifting economic balance of power the Ministry of Economic Affairs, Agriculture and Innovation aims to contribute to the public debate on these important developments. The paper has been written in English in view of the working language of the meetings.

Introduction

The world order is in a state of transition that raises many questions.
China and India are the countries with the largest populations in the word, together totalling more than 2.5 billion people. It is expected that China and India will also take first and second place in economic terms by 2050. The western superpowers (United States, European Union and Japan) that have topped the rankings for decades will have to make do with third, fourth and fifth place. The western countries which had been used to putting their mark on many issues in the world will have to adapt to the changing division of economic strength. In fact, we are in a transitional phase to a new world order which raises many questions, among others, about the development of prosperity in the Netherlands, the future position of the European Union (EU) in the global community and the support we can expect from China and India for sustainable development.

There are also potential sources of international tension. Tensions could arise if, for example, in the future:

1. China and India would not open their markets further to businesses from the EU and the United States (US) while public support in Europe and the US for imports and investments from China and India would diminish.
2. China and India would seek a partnership, possibly with other emerging countries, that could give them a dominant position in international economic forums (e.g. IMF, WTO), just as the EU and the US have had in the past.
3. individual EU Member States would get frustrated about their decreasing influence on the international stage among China, India and the US.
4. serious concerns would develop in Dutch society about increasing numbers of foreign take-overs in the Netherlands, just simply because Chinese and Indian enterprises will have an increasing stake in these take-overs.
5. the rapidly growing middle class in China and India would not call for more attention for sustainability issues.
6. the Chinese renminbi and Indian rupee would take over from the dollar and euro as the most important currencies in the world.

The main aim is to describe developments and potential responses.
This discussion paper intends to facilitate the discussion on the rise of China and India, but it by no means answers the many questions. Firstly, the paper provides a description of the shifting economic balance of power in the world. Secondly, it discusses in general terms how could be responded to this outlook, nationally and internationally. The intention is first and foremost to clarify the issues. An important issue is whether the transitional phase to a new world order will proceed harmoniously, and what contributions the various countries in west and east will make to it. This paper considers open markets for trade and investment an important cornerstone of a harmonious process. Intensifying international cooperation, in economic terms, technological terms but also in the field of sustainability, is another cornerstone. In addition, countries could deflate potential tensions by accepting responsibilities in line with their level of development.

Outlook

Economic growth in China and India continues to be spectacular.
For years, China and India have recorded staggering growth figures, in China's case sometimes topping 10%. A key factor in this is the inclusion of increasing numbers of citizens in the productive business processes. People are able to trade their poorly paid work in the overpopulated countryside or in the informal urban economy for jobs that contribute more to the economy, in particular in industry.

Both economies are now dynamic, and this can be seen in many ways. New infrastructure and entire cities are built in next to no time. Both countries now turn out more than half a million engineering graduates each year. The two countries are the world's number one and two producers of cars and motor scooters. Financial centres like Shanghai and Mumbai are becoming formidable competitors to New York and London. Both countries have emigration, but they also have increasing numbers of returning migrants, attracted by the many new career opportunities. The effects of this dynamic are felt beyond the economy. Chinese and Indian society have seen change in just one generation that our own society saw in a century.

Despite the deteriorating global economic outlook economic growth in both countries is expected to remain on a high level (7 to 9%) in the forthcoming years.

China and India will regain their former shares in the world economy.

In 1820, the Chinese and Indian economies accounted for around 50% of the global economy in terms of volume. In the same year, Western Europe and the United States together accounted for around 25%. Industrial development in Europe and North America in the 19th and the first half of the 20th century caused a turnaround. In 1950, Western Europe and the United States accounted for half of the world economy, and the combined share of China and India had fallen to below 10%.

From the 1960s, the share of the economies in Europe and North America began to fall, while the share of Asian economies has resumed to grow. Initially, primarily on account of Japan and the Asian tigers (including South Korea, Taiwan and Malaysia). From the 1980s, China joined in and India followed in the 1990s. Globalisation and continuing strong growth in the emerging economies therefore brought an end to a period in which primarily the west enjoyed an economic boom. It is expected that the Chinese and Indian shares in world economic output from the beginning of the 19th century will be fully restored in the course of this century.

The middle class in China and India is growing fast.

In China prosperity has seen strong growth since the start of the reform and open up policy under Communist Party leader Deng Xiaoping in 1978. The purchasing power of Chinese citizens has increased on average by a factor of 24 in a little over 30 years, and is now around 18% of the equivalent amount for the average Dutch citizen. In 1978, it was just under 4%.

The growth of prosperity in India was given a strong boost by economic liberalisation under the Narasimha Rao government (1991-1996), a policy that has been continued since then. Average purchasing power in India has increased by a factor of 2.5 in the last 20 years, but is still no more than 8% of average purchasing power in the Netherlands (compared to 7% in 1991). It is likely that average purchasing power in India will grow more rapidly in the coming years.

The Asian Development Bank expects that the number of people with a middle class income, i.e. between $6,000 and $30,000, in Asia will increase to 2.7 billion by 2030. The middle class will grow strongly in China and India in particular.

Poverty is expected to fall further in both countries.

China and India still have many traits of developing countries. Poverty is falling, in China spectacularly so, and most probably will diminish further. Yet many people still have less than $2 a day to spend. And many do not even have $1.25, which the World Bank has set as the international poverty line. In India, one of the largest food producers in the world, more than one million children die from poverty each year. And, according to UN estimates, about one-fifth of its population is chronically hungry.

Estimates of poverty reduction on a poverty line of $1.25 and $2.00 a day, by region

Region	1990	2005	2015	1990	2005	2015
	Population living on less than $1.25 a day (%)			People living on less than $1.25 a day (millions)		
East Asia and Pacific	54.7	16.8	5.9	873.3	316.2	119.0
China	60.2	15.9	4.8	683.2	207.7	66.1
Europe and Central Asia	2.0	3.7	1.2	9.1	17.3	5.8
Latin America and the Caribbean	11.3	8.2	4.7	49.6	45.1	29.1
Middle East and North Africa	4.3	3.6	1.3	9.7	11.0	4.8
South Asia	51.7	40.3	22.4	579.2	595.6	379.3
India	51.3	41.6	22.4	435.5	455.8	276.8
Sub-Saharan Africa	57.6	50.9	35.8	295.7	388.4	344.7
Total	41.7	25.2	14.4	1,816.6	1,373.5	882.7
	Population living on less than $2.00 a day (%)			People living on less than $2.00 a day (millions)		
East Asia and Pacific	79.8	38.7	19.7	1,273.7	728.7	399.4
China	84.6	36.3	15.4	960.8	473.7	213.4
Europe and Central Asia	6.9	8.9	4.5	31.9	41.9	21.4
Latin America and the Caribbean	19.7	16.6	10.7	86.3	91.3	66.3
Middle East and North Africa	19.7	16.9	7.2	44.4	51.5	26.2
South Asia	82.7	73.9	57.1	926.0	1091.5	967.2
India	82.6	75.6	56.9	701.6	827.7	702.0
Sub-Saharan Africa	76.2	73.0	57.7	391.2	556.7	555.6
Total	63.2	47.0	33.1	2,753.5	2,561.5	2,036.1

Source: World Bank staff calculations from PovcalNet database.

The distribution of income in both China and India is increasingly unequal. In particular, universal access to education is important in reducing the gap between rich and poor. Without it, the highly skilled will benefit more from the economic growth than the low-skilled because their scarcity on the labour market will increase.

According to official plans, policy in both countries is aimed at improving the position of poorer population groups. More attention for education, healthcare, housing, infrastructure and environmental management will lead to a better distribution of wealth.

Ongoing specialisation and upgrading will intensify competition.

International trade and foreign investment are key cornerstones of the globalisation process, alongside migrant flows and internet traffic. While global production has increased roughly ten-fold since 1950, global trade has increased by a factor of 30 in the same period. This includes trade in raw materials, intermediate products and finished products. Trade in intermediate products has seen the fastest growth. This is because the production processes have increasingly been split up across various countries and in increasingly sophisticated stages of processing. The ever-improving opportunities for international communication and transport act as a stimulus for the division of production processes.

This development has also led to a strong increase in investments by enterprises outside their own country. The current global total of foreign business investment is twenty times what it was three decades ago. Processes in the production chain that can be performed in isolation are outsourced by enterprises to wherever the cost is lowest and business opportunities are brightest. In this way, multinational enterprises provide a stimulus for countries, including China and India, to develop an economic specialisation. China is a low-wage country that has taken on the role of international assembly centre for electronic products. Partly owing to the use of English among the professional population, India has emerged as a world player in the field of software development.

Further economic specialisation and upgrading of production will take place in both countries. This will bring about more international competition, including in sectors in which Dutch companies are active.

In the coming years, biggest economic growth will be in the east.
In 2009, the financial crisis led to a 12% reduction in global trade and to an even bigger fall in the annual flow of foreign business investment (-39%). International trade and foreign investments recovered in 2010, largely thanks to the stimulus policies of the G20 countries, including China and India. The Chinese package of additional government spending, worth almost €400 billion, appealed particularly well to the imagination. The Netherlands also benefited from this thanks to increased exports to China. Furthermore, the additional spending by China caused a strong recovery in the German capital goods industry, which has many suppliers from the Netherlands.

Recently, the International Monetary Fund (IMF) has downgraded its forecasts for world economy growth to a level of 4% in both 2011 and 2012. A worsening outlook for the advanced economies was the main reason for the revision. The projected 4% is an average of the economic growth in the developed economies and the one in the emerging and developing countries. On the one hand, the revised forecast does assume a growth for the developed countries, including the euro zone, of about 1.5% in 2011 and 2.0% in 2012. On the other hand, much stronger economic growth of more than 6% remains foreseen for the emerging and developing countries in both years. Primarily thanks to continuing strong growth in Asia (except the Middle East) at around 8.0% in 2011 and 2012.

The forecasts are highly uncertain, since the IMF assumes that governments will collectively manage to maintain global financial stability. However, big government deficits in the developed economies (southern Europe, US, Japan) and stressed financial markets in the emerging economies, including China, do constitute a threat which may not be fully averted. This means that world economic growth could turn out lower than the recent forecasts. But even then growth in the east will appear to stay on a three to four times higher level than in the west.

Asia will attain a more central position in the global networks.
In the coming decades, the global economy will also see strong periods alternately followed by leaner years. In the past 30 years, capitalism has spread in various forms around the world. The phenomenon of the business cycle is linked to capitalism. Overoptimistic forecasts by companies of their sales

opportunities is an important source of this. Too much optimism can lead to overcapacity of production, which at some point will have to be eliminated to cut losses. Similarly, excessive optimism regularly causes bubbles on stock markets and property markets around the world. In the future too. And they will burst, because sentiments change, often suddenly. Yet most long-term forecasts do assume further globalisation and continuing growth of worldwide production and trade.

Asia will go on to take a more central position in this. The figures on the next page from a report by PricewaterhouseCoopers show this quite nicely. They show the most important trade routes by sea and air in 2009 and 2030, where each route is the sum total of imports and exports.

In 2009, we see that the US was the biggest hub in globalisation with 11 of the 25 most important trade routes. This is in keeping with the largest economy in the world that offers broad market access to foreign products. The trade route between the US and China occupies the top spot in the ranking. India does not appear among the 25 biggest trade routes in 2009, but the Netherlands appears three times. Dutch trade with the United Kingdom, the United States and China takes 10th, 17th and 19th place in the ranking, respectively[1].

Quite a different picture emerges by 2030, according to PricewaterhouseCoopers. China becomes the most important pole in globalisation with 17 of the top 25 trade routes by sea and air. This position is connected, on the one hand, with growing Chinese demand for raw materials and energy. On the other hand, increasing prosperity in the country will cause a major increase in imports, bigger than the increase in Chinese exports. In particular, Chinese imports of consumer goods are expected to grow fast.

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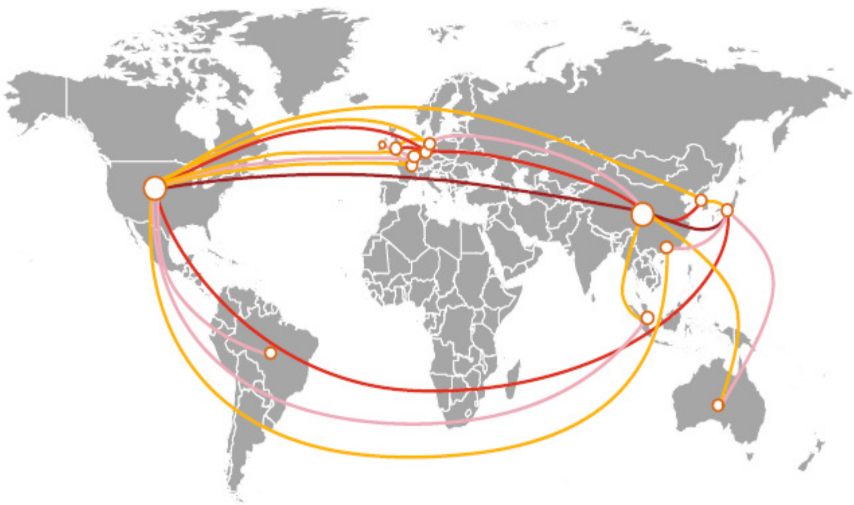
[1] Data on goods transport by road and inland waterways has been disregarded, which is understandable given the globalisation perspective. This means that the overview includes hardly any data on our trade with Germany, which is the Netherlands' most important trade partner.

Top 25 sea and air freight bilateral trade pairs in 2009 and 2030

Top 25 sea and air freight bilateral trade pairs in 2009



Top 25 sea and air freight bilateral trade pairs in 2030

Source: Economic Views: Future of World Trade, PricewaterhouseCoopers, March 2011

Although trade between the developed countries will continue to increase in volume, its significance in global trade will fall. It is only with its bilateral trade with China that the Netherlands appears in the ranking of 25 biggest trade routes in 2030, to wit in 23rd place. The estimated value of this trade in 2030 totals $102 billion, more than double current bilateral trade ($43 billion).

PricewaterhouseCoopers also assumes that the continuing specialisation in the Chinese and in the Indian economies will lead to strong growth in their bilateral trade. A five-fold increase in trade between China and India is deemed possible, good for fourth place in the top 25 trade routes by sea and air in 2030.

Trade links of China and India are increasing worldwide.
Several new entrants in the top 25 list in 2030 concern trade flows between China and other emerging economies, such as Brazil, Indonesia, Malaysia, Nigeria, Saudi Arabia and Thailand. Disappearing from the list are mainly trade relations between western economies.

Trade relations of China and India with African countries are also growing fast, mainly in view of their rapidly growing demand for foodstuffs, fossil fuels and raw materials. Both countries have a strategy of actively reaching out to resource-rich African countries. This gives African countries access to loans for the construction of the infrastructure required for their supplies to China and India. In 2010, mutual trade between India and Africa was worth €33 billion, while mutual trade between China and Africa had reached a value of €88 billion.

Dutch imports from China, worth €31 billion, accounted for more than 9% of our total imports in 2010, making the Netherlands the second largest importer of Chinese goods in Europe after Germany. Dutch exports to China, worth €5,4 billion, totalled up to 1,5% of our exports in 2010. Our imports from India accounted for 1% and exports for 0,5% of total amounts.

Increasing risks of infringements of fair competition and human rights.
Governments and enterprises from emerging economies often move together in foreign expansions. The aid given by emerging economies to developing countries for infrastructure projects often benefits businesses in the country giving the aid. Public tender procedures for the works are often unheard of. This is in contrast with the projects in developing countries for which donors such as the Netherlands provide finance, either directly or through the World Bank. And businesses from the emerging economies even benefit from this aid too,

especially if the developing country in question selects the tender based on price. Usually, competing Dutch businesses do well in the selection procedure with the scores given for aspects of quality and sustainability. However, the inherent higher price is often an impediment for success.

For Dutch companies, the competition is made increasingly difficult when they have to compete with companies whose international expansion is being propped up by a wealthy state. The Dutch government avoids getting involved in a financial scramble with foreign governments, just to make the playing field more level. Often, this would mean a waste of taxpayers' money.

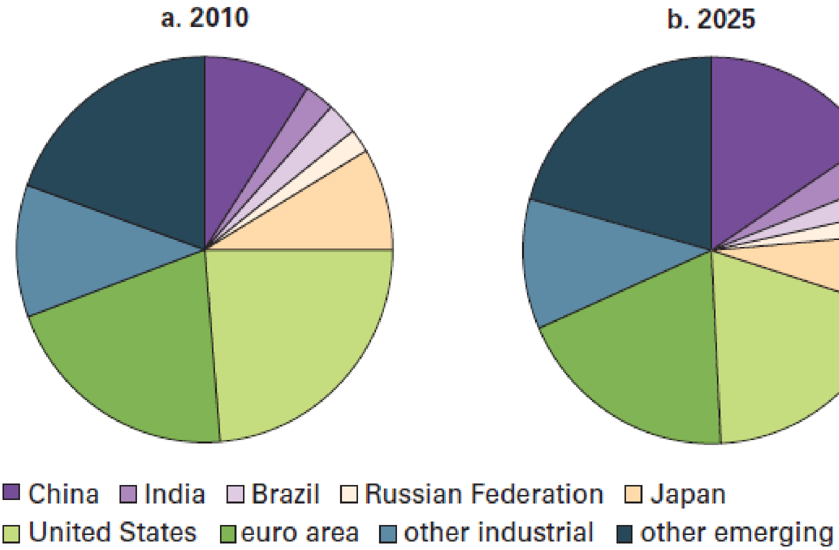
The attention that the host country demands of its international business community for social conditions also influences the playing field. China and India, among others, have both received criticism for turning a blind eye to the policies of the regimes they do business with in their search for natural resources. This includes the dictatorial regime in the Republic of Sudan, which is guilty of serious human rights violations and supporting terrorist groups. This criticism comes not from their own society, but from the west, and its impact is minimal. By contrast, western oil companies have ended their activities in Sudan in recent decades, after coming under pressure from civil society organisations. Some of the western interests were sold on to Asian state enterprises. They contribute to the continuity of the Sudanese oil industry with financial assistance from their governments.

Long-term projections indicate economic growth worldwide.

The World Bank estimates that China and India will account together for more than 20% of global income in 2025, a fraction higher than the 19% that the euro zone and the United States will account for in the same year. This figure of 19% is less than the current share of the euro zone (22%) and the US (24%).

However, this does not mean that the income of the euro zone and US will fall. Because total global income will double between 2010 and 2025, their income will still be higher even with a smaller share in the total. So it is not a zero sum game, in which income growth in the emerging countries would result in a fall in income in the developed countries.

Distribution of world income in 2010 and 2025



Source: World Bank report Multipolarity: The New Global Economy, May 2011

These forecasts do assume that the current level of openness in the global economy will remain at least the same. But that is not an easy assumption to make. It is true that governments are more intensively concerned with bringing order to the markets in view of the international debt crisis and problems of scarcity (biodiversity, climate, energy, raw materials, water). However, it may not be taken for granted that international cooperation will be successful in preventing individual governments from using trade restrictions to safeguard their own country's interests.

Dutch economic growth depends largely on world trade development.
Protectionist measures would certainly harm the Dutch economy. It would be better for the Netherlands if further openness of markets could be assured through international agreements. This would act as a stimulus for world trade, and that would mean an extra boost for a leading trading nation such as the Netherlands. Experience does show that 4% growth in world trade leads to around 1% economic growth in the Netherlands.

Do note, though, that economic openness does not necessarily lead to wealth creation. Countries have to make their efforts to benefit from growth of global

production and global trade. The situation in the euro zone demonstrates this well. After the recovery of world trade in mid 2009, the Netherlands recovered reasonably quickly thanks to the international competitive strength of Dutch businesses. In contrast, countries on the periphery of the euro zone stagnated.
Compared to weaker members of the euro zone the Dutch business environment has several advantages. These include labour income growth that generally does not exceed the increase in workforce productivity, and a moderate interest rate due to appropriate attention for sound public finances.

Responses

Putting stronger focus on internationally competitive sectors.
In coping with international competition, the business community in the Netherlands is continually seeking innovation in products and production techniques. The government attaches great importance to business innovation. Following a review of the government policy in this field, more emphasis will be put on support for Dutch sectors which are able to perform well internationally. Furthermore, cooperation between the government, business and research institutes will be intensified, both nationally and internationally. Nationally, this cooperation should ensure that every euro invested in research and development (R&D) leads to improved business earnings. This can be achieved by converting more inventions into marketable products and technologies.

Internationally, the Netherlands will seek to take more advantage of fast growing knowledge worldwide. The German Centre for European Economic Research has conducted research into enterprises that have R&D centres not just in their home country, but also abroad. These enterprises were found to earn twice as much profit as enterprises that concentrate all their R&D activities in a single country. For companies, it is therefore important to give their R&D an international dimension and, by doing so, benefit from increased knowledge transfer among researchers in different countries.

Cross-border knowledge networks also make it easier for Dutch researchers to further specialise in certain areas. This will build on the good reputation that the Netherlands has for innovation in the field of chemicals, energy, food processing, hi-tech systems, horticulture, life sciences and water management. And this will encourage other countries to hire Dutch businesses and institutions for their projects in these fields. The specialised knowledge on offer certainly appeals to China and India.

Technological cooperation with China and India deserves support.

A number of years ago, a Chinese trade minister remarked that his country has to export 100 million shoes or 800 million t-shirts in order to import just one Boeing aeroplane. It is therefore understandable that China and India, among others, want to improve their own technological performance. Raising the standard of education and encouraging R&D are therefore priorities, but so too is technology transfer from foreign businesses to their local companies.

Lift-off of the Chandrayaan-1 spacecraft, Sriharikota, India

There is a growing willingness for technology cooperation among Dutch enterprises to help them gain access to these fast-growing markets. Fokker Technologies, for example, signed a wide-ranging agreement last May with Chinese aircraft builder Comac. Apart from the supply of aircraft parts, the agreement also covers cooperation on the design of new aircraft models. Fokker Technologies is also helping improve aircraft maintenance.

Not only Dutch businesses, but also our research institutions are taking advantage of the increased attention for R&D in Asia. For example, Delft University of Technology has opened a research centre at the Chinese Academy of Science in Beijing for the further development of highly efficient LED technology. India is also an important destination for Dutch knowledge and technology, in particular in agriculture and horticulture, the food-processing industry and the water sector.

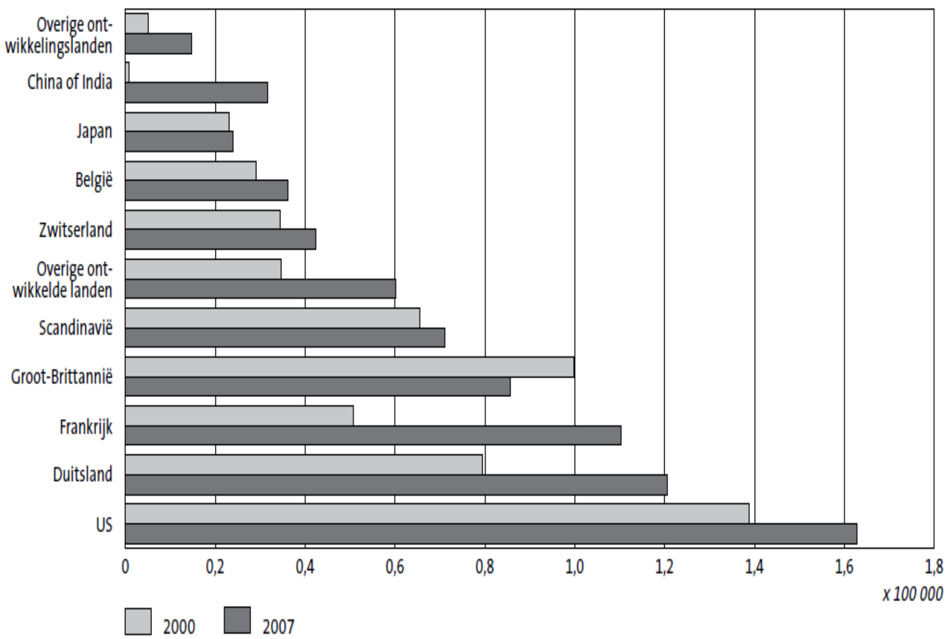
The Dutch government stimulates scientific and technological cooperation with China and India through an active policy dialogue with the governments of these two countries. One of the recent outcomes is an action plan agreed upon by the Dutch Ministry of Economic Affairs, Agriculture & Innovation and the Indian Ministry of Agriculture & Food Processing Industries. It aims at stronger cooperation to improve Indian agriculture and food processing. Dutch companies and institutions will, for instance, provide assistance with innovations in the seed sector, development of horticulture, optimisation of food processing and the reduction of losses in the entire supply chain in India. The Dutch agribusiness sector expects that the intensified technological cooperation will result in increasing opportunities for supplying India. Agricultural exports to India could triple to €1 billion a year in the next 5 to 10 years.

Foreign companies contribute to R&D in the Netherlands.

Dutch businesses and research institutions can only benefit from global knowledge growth if enough research is conducted in the Netherlands itself. So there is a need for Dutch researchers who are able to get to work with useful knowledge from elsewhere. Attracting foreign companies to set up an establishment in the Netherlands is instrumental in maintaining a strong knowledge base and research activities in the Netherlands. Foreign companies account for as much as 33% of total R&D in the Netherlands. They also appeal to the most talented workers from other countries. Foreign companies who conduct research prefer to establish themselves close to universities and research institutes with a good reputation in their own area of technology.

There are until now only a few Chinese and Indian branch offices in the Netherlands that conduct R&D activities. Most Chinese and Indian branch offices in the Netherlands are European head offices, sales offices or logistics units. These branch offices strengthen the position of the Netherlands as the Gateway to Europe, especially for the flow of goods between China and Western Europe.

A good business climate will attract more Chinese and Indian investment. In general, Chinese and Indian investments only represent a small share of total foreign investment in the Netherlands. Dutch branch offices of Chinese and Indian businesses together provided around 30,000 jobs in 2007. A good number, but significantly less than the 160,000 jobs provided by American branch offices or the 120,000 jobs provided by German branch offices in the Netherlands.



Trend in the number of jobs in the Netherlands at foreign-owned businesses according to country of control from 2000 – 2007 (source: CBS).

We can expect to see an increase in Chinese and Indian investment in Europe in the period ahead. Chinese and Indian businesses will establish themselves closer to their potential European customers so they can more easily increase their market share. It is not expected that Chinese and Indian multinationals will often choose the Netherlands as the location for production sites. The cost of labour and the limited size of the Dutch market do not work in the country's favour. Continuing growth in Chinese and Indian head offices, banks and businesses with marketing, sales and logistics activities is more likely. The Netherlands will, of course, have to continue to offer a favourable business climate compared to other western European countries. Particularly in the area of logistics, the Netherlands is seeing increasing competition from neighbouring countries.

Public interests will remain well safeguarded in the Netherlands.

Mergers and acquisitions represent an important part of total foreign investment in the Netherlands. Foreign enterprises are involved in almost half of all mergers and acquisitions in the Netherlands. So far, few enterprises from China and India have been involved, but that will change. On their expansion into Europe, Chinese and Indian enterprises can expect intensive competition from European businesses with strong brand names. Chinese and Indian enterprises will possibly try to take over or merge with the European competitors. This could also be a sound way of preventing overcapacity. Apart from that, acquisitions can improve the prospects of the original Dutch business. Hoogovens and Vredestein gained new opportunities thanks to takeovers from India, and the same is true of Burg Industries and ECT (container handling) thanks to takeovers from China and Hong Kong.

Furthermore, the Dutch business community is also a key investor in foreign countries. In 2010, the Netherlands ranked 7th place among the countries with the largest holdings of foreign businesses with a total of $890 billion. Many Dutch multinationals have establishments in China and India, some have even been there for decades. An expansion of these investments can be expected. For instance, this year Philips took over a Chinese and an Indian manufacturer of kitchen equipment.

Investment made by foreign companies may also have some disadvantages which need to be addressed. Western societies sometimes worry about takeovers when control of domestic business moves to the head office in a country where the state has a major influence in the economy. There is a fear that these takeovers are not only inspired by commercial motives, but that political influence is also an objective. This could be the case, for instance, with the acquisition of the management company of an important port. While such a risk is not purely an imaginary one, concrete indications are difficult to find.

In general, countries protect public interests with legislation that defines what private companies may and may not invest in, and sets out the boundaries within which businesses can operate freely. Regulatory bodies enforce the rules. The Netherlands has safeguarded its public order and national security interests through legislation and strategic public shareholdings (for example, Amsterdam Airport Schiphol). And the country is also at liberty to take additional measures, should it feel the need to do so.

More Dutch companies will have to make their way to Asia.

The EU is the home market for Dutch exporters, especially for small and medium-sized enterprises (SMEs) that export. Around three-quarters of our exports go to other EU member states. In 2010, only 2% of our exports went to China and India combined. This means that the Netherlands scores lower than the European average. By contrast, Dutch multinationals have an above-average number of production locations in both countries.

For Dutch SMEs, it will become more interesting to also look towards these fast-growing markets. The market size of China and India together is almost half that of the EU market, but the annual economic growth is around four times higher than in the EU. The distance to the Chinese and Indian markets and the language barrier only partly explain the limited export figures. Companies also find it difficult to do business there because of formal barriers such as import duties and permits, next to all kind of bureaucratic red tape. Finding the right business partners is usually also more time consuming in Asia than in Europe.

Moreover, the ties between the governments of these countries and their national business communities also deter foreign entrepreneurs. Occasionally, these ties are so close that they result in discrimination of foreign enterprises. This applies, for instance, to the award of permits, public procurement and credit terms. These countries often also want foreign governments to vouch for the expertise and reliability of new partners of businesses and institutes in their country. For this reason, China and India are among the group of countries that are in sharp focus in the Dutch government's export policy. On a regular basis officials lead economic missions to these countries. Furthermore, Dutch businesses can rely on the services of local embassies, consulates and Netherlands business support offices. Dutch diplomacy is regularly successful in improving market access for Dutch entrepreneurs, sometimes in cooperation with local representations of the European Commission.

Corporate social responsibility deserves wide-ranging attention.
China and India generally have reasonable legislation that helps prevent social misconduct. Yet it still happens. Therefore, Dutch enterprises are well-advised to take this into account when doing business with Chinese or Indian companies. It is important to give adequate attention to corporate social responsibility (CSR) in business relationships with Chinese and Indian partners.

In China as well as India, CSR is increasingly gaining a solid foothold. The 12th five-year plan of the Chinese government intends to achieve sustainable economic growth with more attention for social and environmental factors. Companies will have to contribute, for instance, through the payment of a higher minimum wage. In July 2011, the Indian Ministry of Corporate Affairs published extensive CSR guidelines for Indian businesses. Yet it is not only the international enterprises and the large Chinese and Indian enterprises that are getting to grips with CSR. Local businesses are increasingly adapting their processes to the international social standards.

The Dutch government supports the CSR efforts of Dutch enterprises by sharing information and by cooperating with the Chinese and Indian governments. Agreements were made with the Indian government in June 2011 on the sharing of information and experience in the field of CSR. The aim is to ensure companies are more aware of the ways in which CSR can be implemented when doing business in India. One of the first activities was a seminar to discuss the significance and application of various CSR Guidelines (such as those of the OECD, the Indian government, and the International Organisation for

Standardisation: ISO 26000). Particular attention was given to combating child labour and discrimination in the workplace.

Sewing workshop in China

In China, the Benelux Chamber of Commerce has launched a website about CSR in China (http://csrproject.bencham.org/). Part of this is a CSR platform that gives companies the opportunity to share experiences on difficult issues, such as how to broach the subject of working conditions at a Chinese business partner.

Universal human rights belong to the agenda of economic missions.
Standing up for human rights is a key focus in the foreign policy of the Netherlands. This is founded on the principle of the universality of human rights. The human rights established in international conventions apply to all people, at all times, everywhere. The Netherlands therefore expects human rights to be respected by the emerging superpowers, such as China and India. Furthermore, these are countries that want to see their economic status better reflected in their

positions in international organisations (IMF, World Bank, UN, etc.). While this is understandable, it does raise questions of what role they want to play in other areas, such as the field of universal human rights. The Netherlands regularly raises issues of human rights at official encounters with these countries, meetings during economic missions included. Human right subjects are sensitive issues and need to be handled with care. Though the Netherlands believes that there is more to normal bilateral relations than merely lobbying for trade.

China and India usually fend off western criticism of their human rights record by highlighting the rapid improvement in living standards in their country. In their view, western countries often overlook the local circumstances that make it difficult to adequately respect human rights. In this respect, they point at their stage of development and the related priority given to economic progress, the risks to national unity and security, and also cultural and historical backgrounds

Increasing interdependency necessitates international cooperation.

Today's multi-polar world, with its intensive flows of finance, goods, expertise and ideas, is a stimulus to economic development that stretches to the furthest reaches of the world. At the same time, countries are becoming more sensitive to deficiencies in each other's policies, as we saw during the financial crisis. We are also increasingly dependent on each other for solving problems. This is demonstrated by the role that China plays in keeping the euro zone viable. China is expanding its investments in European government debt and is acquiring privatised businesses in the weaker countries of the euro zone. This means that China, to a certain degree, is accepting financial risk that prevents the possibly greater risk of a downturn in an important market for Chinese exports.

Now that people in different countries have become more dependent on each other, it is appropriate to jointly limit the risks that could negatively impact on all parties. Most countries therefore realise the benefits of international cooperation. Examples include joint oversight of macro-economic policy in individual countries and of the activities of major financial institutions, or combating tax havens and cross-border cartels, the suppression of dangerous viruses such as SARS, and the joint fight against deforestation. China and India are increasingly active in this international cooperation.

Keeping broad international support for a rules-based trade system.

There is a well-developed system of regulations in international trade under the auspices of the WTO. It plays a key role in securing open markets and fair competition. Almost all countries in the world, including China and India, are members. The WTO can issue binding decisions to resolve disputes between countries on the application of the rules. That the strong economic downturn in 2009 was not exacerbated by import restrictions is, in part, due to the international trade rules. In contrast to the economic depression in the 1930s, countries largely refrained from protecting jobs by raising import duties. However, other restrictive measures did increase, such as the exclusion of foreign businesses from government procurement procedures and the tightening of technical specifications for foreign products. Fortunately, this did not lead to a vicious circle of import-restricting measures that could have dragged all countries down into a deeper crisis situation.

The popularity of restrictive measures against foreign trade has also fallen thanks to production processes being divided across various countries. When products were produced entirely in one country, it was easier for governments to help national manufacturers by excluding products from foreign competitors. Today, there are more likely to be conflicting interests within a single country. For instance, between the manufacturer of a product in country A and the makers of parts in country A, who supply the manufacturer of a competing product in country B. The manufacturer in country A has an interest in cost-increasing measures for the manufacturer in country B, but the suppliers would be hit by the worsening competitive position of the manufacturer in country B.

Strengthening of the multilateral trade system is needed.

Yet the current trade system still offers sufficient scope for governments that want to give preferential treatment to national interests to the detriment of other countries' interests. This is true, for instance, of the scope to provide subsidies to national companies, which could distort fair international competition. Imposing export restrictions on raw materials and foodstuffs could also distort normal market operation. Export restrictions can unleash a chain reaction of additional supply constraints, causing rapid price increases in the global marketplace. This happened last year when Russia, beset with poor harvests, imposed an export ban on grain. Because other countries, such as Argentina, also exported less than normal, grain prices worldwide shot up. Poor people in food-importing developing countries suffer most from drastic measures like these.

China gives preferential treatment to national companies by imposing export restrictions on raw materials that are only extracted in limited quantities outside China (e.g. bauxite, magnesium, zinc, fuel coke and rare earth elements). China considers the sales restriction necessary because of the serious environmental pollution caused by mining activities. The WTO recently ruled that some of these restrictions discriminated against foreign business, and were therefore incompatible with international trade rules[2]. China announced its intention to appeal against the ruling, but also said it would abide by the WTO's final decision. This Chinese attitude makes a contribution to the significance of the multilateral trade system. Though the current trade rules do not allow for the correction of all unfair measures by governments. Therefore, it would make sense to tighten the rules.

Bilateral trade agreements may not undermine the multilateral system.
At present, there is little international enthusiasm for changing the international trade rules. Negotiations have been going on since 2001 to liberalise international trade under fair conditions. These negotiations, known as the Doha Development Agenda, are intended to give developing countries in particular increased opportunities to sell their goods. The EU put in good proposals to help achieve this, but others, such as the US, seem less motivated to see the negotiations successfully concluded.

Since there is little progress in global negotiations, individual countries are trying to arrange new trade agreements among themselves. While understandable, this does risk causing a patchwork of differing rules in international trade. This approach should therefore not be allowed to seriously delay the strengthening of the global trade system. An example of the bilateral trade agreements are those made by the EU, in part on behalf of the Netherlands, with Chile and South Korea. This kind of agreements creates new trade and investment opportunities

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[2] The dispute brought before the WTO did not concern the more recent export restrictions on rare earth metals, which are increasingly used in electronic equipment.

for Dutch companies. They also give Dutch companies more legal certainty when doing business with Chile and South Korea.

In particular, free trade agreements with countries that have a great number of state enterprises, such as China, could mean an important leap forward in opportunities for Dutch enterprises. In such countries, national networks are a key factor in the award of orders in sectors such as energy, environmental management, public health and water management. Though it remains to be seen whether in practise new trade agreements really do lead to major changes in the traditional methods of awarding orders.

Currently, there is no prospect of the EU and China starting serious negotiations on further liberalising mutual trade. Both want to first concentrate on providing a stimulus for bilateral investment. However, the EU is negotiating with India on a bilateral free trade agreement.

Better balance in the US-China economic relationship is desirable.
The US is less expeditious with concluding bilateral free trade agreements than the EU. The Americans are more concerned with the monetary policy of other countries. The US is urging China to give the value of its currency a big boost so that businesses in the US will find it easier to compete with businesses in China. The exchange rate of the Chinese renminbi does not come about as a result of free currency trade. Instead it is strongly controlled by the Chinese central bank. This calls in question whether the current exchange rate truly reflects the fundamental power of the Chinese economy. However, opinions vary widely on the question of what the correct exchange rate of the renminbi should be, and whether the Chinese government is giving an excessive advantage to its own exporters. In any case, rapid rises in the cost of labour in China mean that any competitive advantage from an undervaluation of the currency is diminishing.

In response to American criticism of Chinese currency policy, the Chinese have criticised American fiscal and monetary policy, and the financial markets are increasingly concerned about this too. This development could lead to sensitive losses for China, which owns nearly $2 trillion in US public debt ($14.7 trillion).

It is extremely important that the current numbers 1 and 2 in the world economy do not let their differences of opinion escalate too far. There are reforms possible that could make bilateral economic relations more balanced. The entire global economy will benefit from these.

Consideration needs to be given to Europe's international influence.
The four European countries that are members of the G7 – Germany, the United Kingdom, France and Italy – will see their economic might gradually diminish in the decades ahead. Ultimately, European economies will only be able to maintain their position among the largest economies as an EU bloc.


European countries could disappear from the world's top 10 economies after 2050

	2010	2020	2030	2050
1	US	China	China	China
2	China	US	US	India
3	Japan	India	India	US
4	India	Japan	Japan	Brazil
5	Germany	Russia	Brazil	Japan
6	Russia	▼Germany	Russia	Russia
7	Brazil	Brazil	▼Germany	Mexico
8	UK	UK	Mexico	Indonesia
9	France	France	France	▼Germany
10	Italy	Mexico	▼ UK	UK

Source: 2020 Euromonitor, 2030 and 2050 PwC all data based on purchasing power parity using IMF 2010 base

To remain a significant factor in the global economic order, there appears to be only one sensible option: deciding to make the EU one of the global players. The best way to do this is to speak with one voice as often as possible. This has already been the case for many years in the World Trade Organisation (WTO). It ensures a strong position for Europe among the other major powers.

The traditionally large influence of Europe in economy and finance faces great pressure. In the financial crisis, the G20 – in which China and India are represented – took a prominent role rather than the G7, in which Europe holds four seats.

The waning role of Europe is characterised by the promise that the European countries on the IMF Board had to make in late 2010. Europe (without Russia) has eight seats on the IMF board out of a total of 24 seats and will have to relinquish two of its seats to the emerging countries. This will probably be at the expense of smaller countries in Europe, such as Belgium, the Netherlands and Switzerland, who each have one of the 24 seats, making them leaders of a constituency of several countries. Possibly, the Netherlands and Belgium will share one seat in the future. It is highly likely that the large EU member states will also have to relinquish some seats at some point in the future. So that could be a good time to seriously consider representation on the IMF board by a single EU seat.

China and India can substantially contribute to global sustainability.

While China and India play their parts in the politics of international economic, financial and trade cooperation, they could play a more active role in global sustainability issues. This would be beneficial to the efforts of the Netherlands and Europe towards having more sustainable production and consumption in the world.

An example of an important global sustainability issue is the management of climate change as a result of CO2 emissions. At the signing of the Kyoto Protocol in 1997, the highly developed economies of the EU, the US and Japan agreed the most stringent CO2 reduction targets. By contrast, the developing countries of China and India were exempted from any reduction obligation for the period until 2012. Ultimately, the US never ratified the protocol.

The Kyoto Protocol comes to an end next year, but it is extremely uncertain whether a new protocol can be agreed. Since the failed summit meeting in Copenhagen, only limited progress has been made. The developed economies want emerging economies like China and India to also commit to reduction targets for their CO_2 emissions. China in particular opposes this given its status as a developing country. Yet without the efforts of the country that accounts for one-quarter of global CO_2 emissions, a global agreement seems unattainable. And fairly pointless too. While it is true that Chinese CO_2 emissions per capita are only half what they are in the Netherlands, these emissions are increasing fast.

U.S. President Barack Obama, Chinese Premier Wen Jiabao, Indian Prime Minister Manmohan Singh, Brazilian President Lula da Silva and South African President Jacob Zuma in a coordination meeting during the United Nations Climate Change Conference in Copenhagen, Denmark, December 18, 2009. The EU, conspicuous by its absence.

Their attitude towards bottom-up sustainability efforts is also essential.

Making progress in the field of sustainability does not always require the conclusion of a top-down multilateral agreement. On the contrary, joint efforts are made by individual governments, business communities and civil society organisations with the aim of making the production chains of natural produce more sustainable. Lasting improvements are being pursued, for instance, in the production chains for chocolate, palm oil, soya and tropical wood. Operations across the entire chain are monitored based on standards for the production conditions. These standards set out criteria for working conditions, earnings, sustainable agriculture methods, environmental management, respect for local populations and biodiversity conservation.

Support from as many governments, business communities and civil society organisations as possible is needed to give sustainable products a chance of success in the face of competition from non-sustainable equivalents. Given the increasing role of China and India in international trade, their participation in bottom-up initiatives to improve the sustainability of a given production chain will increasingly prove to be crucially important.

Even the scope for EU sustainability efforts is partly dependent on them.
The measly support around the world for agreements to stop climate change also makes it more difficult for the EU to implement initiatives in its own territory. For instance, in implementation of its obligations under the Kyoto Protocol the EU has limited CO_2 emissions allowances by sector. Some allowances are awarded to companies for free, while some have to be paid for. The aviation industry has so far been exempt from the EU's CO_2 emissions policy. This is set to change from 2012 as a result of the EU's planned 20% reduction of total CO_2 emissions in the region between 1990 and 2020. The intention is to charge airlines for their CO_2 emissions on flights within the EU and between the EU and third countries. In 2012, the purchase of limited CO_2 emissions credits will be worth €1.4 billion. As a result of continuing growth in air traffic, this figure will rise to €7 billion by 2020.

These measures have met with opposition from non-European airlines, including American and Chinese airlines. Legal action has been threatened for the EU's purported violation of international agreements. In response, European airlines have expressed their concerns about possible tit-for-tat measures. Non-European countries might impose additional levies on their flights or cut their landing rights. Europe's figurehead Connie Hedegaard, EU Commissioner for Climate Action, remains undeterred for the time being. Though she does not exclude the need for a compromise with the Chinese government, among others.

In summary, we may all benefit if Chindia will be among the rulers.
This discussion paper started with mention of three cornerstones of a harmonious transition to a new world order: open markets, international cooperation and acceptance of responsibilities in line with levels of development. As Asia is now taking a more central role in the global economy, the US and the EU are no longer able to guarantee a harmonious process even if they wanted to. The status of the US as a superpower is diminishing, and the EU has insufficient leverage to take over that role. Emerging superpowers, such as China and India, are needed to share leadership of a process of sustainable globalisation. Besides, their standing among developing countries gives them an advantage.

Countries that want to lead the world community could limit risks of international tension by:

- guarding against an overdependence on exports and foreign capital
- ensuring equal treatment of foreign and domestic businesses
- joining initiatives to encourage corporate social responsibility worldwide
- providing support to global and sectoral sustainability efforts
- enabling multilateral organisations to function effectively in accordance with current relationships and capacities
- strengthening the rule of law at home, in part aimed at safeguarding universal human rights
- providing public services so that the poor can also benefit from wealth creation

Driven by the right ambitions, it could be beneficial for the global community if 'Chindia Rules!'.

Do you agree or disagree? We would like to hear your views and ideas.
Please send you comments by e-mail to n.a.j.langemeijer@minez.nl.

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