

Living in the Shadow of China

*[Arvind Subramanian is author of *Eclipse: Living in the Shadow of China's Economic Dominance*, published this fall, in which he argues that China will surpass the US as the world's leading economic power sooner than many people think. He is a senior fellow at the Peterson Institute for International Economics and the Center for Global Development, and formerly held the position of assistant director in the research department of the International Monetary Fund. NYF Team spoke with him on September 6, 2011. Excerpts:]*

NYF: By 2030 you think China may be as far ahead of the US as the US was ahead of its closest rivals in the seventies. Could you elaborate how you reached that conclusion?

AS: First of all it's based on what one means by dominance and how one can measure dominance. I posit that economic dominance can be summarized in three aspects of the economy. It's the size of a country's economy (GDP), its trade, and the extent to which it is a net creditor. I combined these and created an index, and computed the index going back to 1870. When I computed the index for China in 2030 the difference between China and the others is very similar to the US and its rivals in the 1970s.

So, for example, in 1970 the US was the largest economy in the world. By 2030, by some measures I feel that the Chinese economy will be about one-and-a-half times that of the US economy. Similarly its trade will be one-and-a-half times that of the US, and of course we know that China is a big creditor to the world, which confers a lot of power on it. China buys American bonds so it has the power to determine how big a deficit the US can run.

NYF: In a recent *Foreign Affairs* article you described how, during the Suez crisis in 1956, the US threatened to withhold financing from Britain unless it withdrew from the Suez Canal. Harold Macmillan, British chancellor of the exchequer, said that Britain experienced "the last gasp of a declining power" at that time. Are you suggesting that the US is in that position now?

AS: In the case of what happened with the UK in 1956, which is what Harold Macmillan was talking about, the US humiliated the UK because the UK needed money to deal with the crisis and the US said, "No, not unless you pull out of the Suez Canal area." So the UK had to comply to the exercise of power by the United States.

The US is not quite in that situation as yet—it's not a "last gasp" in the sense of being humiliated. But we do see certain other signs that are similar, the biggest example being the fact that the US has wanted China to change its exchange-rate policy for the last three or four years, and the US and the rest of the world have simply been unable to do so. If you interpret a declining power as a power that's not able to get its way, then we already see manifestations of that for the United States, although not in the extreme form that we saw in 1956 for the United Kingdom.

NYF: IMF figures earlier this year indicated that China will be economically dominant by 2016, using purchase power parity (PPP) terms. How does that fit with your picture?

AS: In fact, I think the IMF is underestimating GDP at purchasing power parity. I had a piece which got a lot of attention about three or four months ago when I showed that China's GDP measured in purchasing power actually overtook that of the US in 2010. You don't have to wait till 2016 as the IMF claims. It has already happened. In that sense the IMF is a little bit behind.

NYF: So China is already ahead?

AS: In terms of the GDP purchasing power. But also remember that China is a big net creditor and the US is a big net debtor. That is a big part of the shifting power balance. If you're a debtor you're in hock to the guy who finances you, otherwise you're in trouble.

NYF: Some people think that China may have its own financial crash. Could you tell us why you think this won't slow China down?

AS: One needs to be clear: will China slow down over the next twenty years? The answer is absolutely, 100%. Will China have some kind of financial crash or financial market crisis? I think that in the next five years there's a very high probability, yes. But everything that I'm saying already factors these things into account. I assume that China is going to slow down considerably from its current pace of economic growth. At the moment it's growing something like 11%, 10.5%. I assume it will slow down to 6.5% or 7%.

China does not have to grow at the current rate in order to become dominant. Yes, China is going to have internal problems. Yes, China may also have financial market problems and even a financial crisis. People think, "Oh my God, China is going to slow down!" It's almost inevitable that China will slow down, but even with the slowdown, China will be dominant.

NYF: Why do you think the US has not acknowledged the seriousness of the situation?

AS: There is a deep belief in American exceptionalism, that there's something special about the US and therefore that "We can't be displaced—yes we have problems, yes, there's China, but somehow we'll rise to the challenge and do all the things that are needed to head off this challenge."

Now this belief in exceptionalism is of course true of almost every power in history. In fact in James Joyce's *Ulysses*—which I quote in the book—when Dedalus (who is Irish) is asked what is the Englishman's proudest boast, his irony-laced response is, "On his empire the sun never sets." Every power in history has this feeling that their dominance is going to continue.

I think it's a combination of that and not really facing up to the fact that in this case, the arithmetic vis-a-vis China—there's an inexorable set of developments that make the whole China thing very different from any challenges they've had in the past. They have not completely got to grips with that. The combination of this collective ego—exceptionalism—and not fully recognizing that there is something very special and unique about this new Chinese

challenge... I think that combination explains this slight complacency or even hubris, on the part of the US.

NYF: Have the other BRIC countries —India, Brazil, Russia—fallen by the wayside?

AS: It's not that they've fallen by the wayside. I think India's turn will come. I don't think Brazil and Russia have the size to ever be as dominant as the other countries. I think the only other potential claimants to superpower status in the future would be India, and maybe Indonesia but I'm not sure.

Over the next twenty years, India will certainly be behind China. During the twenty-year horizon I have in mind, which is the subject of the book, China is the big challenge and China is the big power. India's turn will come later.

NYF: Is the outcome you suggest inevitable?

AS: That is an interesting and important point. Part of the American conceit is that they control who's going to dominate. My view is that that's again a little bit too complacent because China's growth, on which all this dominance depends, is almost completely China's to determine.

For the US, by virtue of being such a rich country, there are limits to how much and how fast it can grow. That's in the nature of things: rich economies sputter along at 1.5% or 2% growth, dependant upon periods of buoyancy, when they make huge technological progress, and there are periods of collapse as we see now. But the range of outcomes is much more limited. I call this the curse of being at the frontier.

For China, on the other hand, because it's so much poorer, the scope for either doing very well, or conversely doing badly, is much greater. But that, China controls. It's China's to control, and if China does a reasonable job, it is inevitable. □□□

[Source: *Marx Laboratory*, 26 Sep 2011]