2. The rise of TNCs from emerging markets: the global context

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I would like to frame a few of the broader global conditions in which this topic will proceed in substance for some time to come. I want to give a kind of macroeconomic overview, and a very brief one indeed, rather than a microeconomic assessment of the particular issues of outward foreign direct investment (FDI) from emerging markets.

There is little doubt that, barring a catastrophe, we are living in an age that will be marked by the biggest economic change in the history of recent centuries. It will have, in its geopolitical impact, a role comparable to that of the Industrial Revolution, which is one of the great ruptures of history. We are now living in the age of convergence of economic performance, after several centuries of divergence. Since around 1500, the North Atlantic economies – for a lot of very complicated economic, political and military reasons – rose in dominance over the course of 450 years, so that, by the middle of the twentieth century, the shared dominance of the United States and Europe completely defined the global economic reality. Of course, the Cold War was the dominant survival issue for the world, but the dominant economic issue was the unprecedented concentration of economic power in the North Atlantic economies, and all that it meant for society, technology, culture and so on.

The rise of the North Atlantic countries was a long process. It was most fundamentally made powerful by the discovery of trade routes to the Americas and, even more importantly, it was accelerated dramatically after 1800 by the Industrial Revolution in the nineteenth century. It was an age of profound divergence. Starting from rough equality of economic activity around the world as late as 1800, one small part of the world, the North Atlantic, surged in economic weight: according to estimates by Angus Maddison, the Asian economy went from about 60 per cent of world GDP in 1820 to about 23 per cent by 1970 (Maddison 2001).

That was extraordinary, and rather unusual in economic terms, because generally, there are powerful reasons to believe that divergence should not be a hundred-year process, but rather, that it should be a process that is overtaken by powerful forces of convergence. That did not happen for a long time. The unprecedented thrust of science-based, technological advance that took place in Western Europe, and the ensuing military advantage, gave divergence 150 years or so of life. That is unusual in any grand sense and almost impossible in any economic model. The world is not supposed to be like that. In one of the most important passages of modern social thinking, Adam Smith ([1776] 1904) wrote about the discovery of the trade routes to the Americas and to Asia from Europe as being the two most significant events in the history of the world. He wrote that these two events should have strengthened all of the world, but by an accident of history, they occurred at a time when the military advantage of Europe was so large that it ended up wrecking the native economies and societies of the East and West Indies. Smith also wrote that we have to look forward to the day when this accident will be righted, and when there will be a balance of fear sufficient to provide mutual benefit that should come from globalization. And Smith went on to say, in this unbelievable paragraph of wisdom, that it is trade itself, and the flow of ideas, that will be the re-balancer in the world eventually, so that there will be a return to convergence, and it will be mutual fear that will eventually lead to the mutual respect and the mutual benefit that can come from the globalization process.

My essential point is that the 'tricks of the trade' of technology-based, market-led development are now known everywhere, and they are basically being implemented everywhere. The very specific historical period in which the West, meaning the North Atlantic, was dominant, is over, because what fueled that process is now being overtaken by extremely powerful forces of convergence. The main forces of convergence are technology, which is available everywhere in the world, and the essential instruments of economic development, which are now shared by most of the world, and certainly by the largest nations, China and India. We are on a path that is different from the path of the past 450 years, which ended roughly around 1950. For China, the real convergence only started after 1978. One could say that in India, it had a long, very slow start until 1991. But convergence is now a very deep process.

Economics, or the kind of economics that I was raised in and that I practice in my general thinking, takes convergence as a much more natural phenomenon than divergence. Divergence depends on two things. It depends first on only one part of the world having the magic elixir of science-based innovation and, second, on political dominance. Those are both ending. Political dominance really has been unraveling. There is no longer such a thing as a successful occupying army anywhere in the world. At the same time, the economic organization required for innovative growth is also broadly shared. According to my estimates, China's share, or Asia's share, of world GNP will rise to more than 50 per cent of world GNP by 2050, up from 23 per cent in 1970, and roughly 38 per cent in 2000.[1] The reason that more than half of the world GNP will be in Asia is that more than half of the world's people live in Asia. So the real question is why not? What would stop that kind of convergence from happening? Asia is where the people are, and the people now are empowered with tools, competent universities, research labs, research and development (R&D), and all sorts of modern tools, especially cell phones, computer terminals and the internet.

Thus, my starting point for our topic is that there really is fundamental change. The idea of FDI coming from emerging markets is going to be the norm. Again, why not? Of course we are going to have major firms headquartered in emerging markets – it is just unusual for us to think in those terms. Since social attitudes lag reality by 15 years, the public ethos will lag behind for a while. So for a while, we will be horrified at who is buying what, but we will get over it, because that is the nature of the world we inhabit. Trends that seem surprising now will not be quite so surprising over time.

The second important, basic macroeconomic fact is that China and India are moving beyond the Asian model of catching up. That model is essentially a workshop model, which involves bringing in capital and technology, assembling it and then re-exporting it. From 1960 to 1985, the workshop model fueled Asia's rapid catching up. It was a good model that made sense with skilled, numerate, literate, low-wage labor. There is still is a lot of that kind of growth left. But there is no doubt in my mind that we are already well past the threshold at which Asia has entered the era of endogenous growth, fueled by its own innovation and heavy investments in R&D. Much more of that is going to happen.

Of course, Japan has demonstrated this for three-quarters of a century or more, and it was Japan's knowledge base that fueled a part of Asian industrialization in the flying geese model.[2] But it is already evident that there is a great deal of innovation in China and India (not to mention in the Republic of Korea, Singapore, Taiwan Province of China and so on), as well as substantial R&D investment, in the context of movements for integration of the Asian economy. As a result, the idea that these economies will merely continue to serve the US market or the European market is going to be passé in a relatively short time. We are seeing the development of an independent, major growth pole of the world economy. It will probably become the biggest growth pole by the mid-century, a knowledge- and R&D-led development process in the framework of a substantially integrated Asian economy. In fact, there is also the inevitable increase in importance of South–South trade and investment. There is, for example, an increasing presence of China in Africa. As someone interested in

African development, I think this is good. The South–South dimension is real, and it is part of the shift to knowledge-based growth in the emerging economies.

My third point is that we do not have dual economies, but triple economies, in China and India. They are quite complicated and we do not have good models for them. First, we have a very high-tech, world-class R&D end, which will grow. Second, we have the workshop of the world, standardized mass production of a lot of manufacturing. Third, we have hundreds of millions of poor people in the countryside. That is the triple economy. We need to recognize how rich the economic structures of Asian economies are. As a result, we need something more than Lewis's two-sector model (Lewis 1954): we need at least a three-sector model to even understand these economies. In reading the chapters of this book, I think a lot of the mixed signals that are coming through in some of them are because many different effects are coming through in the data. Outward investment is not only coming from plain vanilla manufacturing, low-cost investors; it is also coming from high-tech firms. In fact, since a part of these economies is already at the high-end, R&D, knowledge-based stage, one would expect outward investment for all the reasons that the knowledge-based industries of the developed countries have invested abroad. That Infosys (India), for example, is investing in the United States is therefore not surprising. It is happening for the same reason that knowledge-based industries in the US have long been expanding abroad. Overall, convergence is so powerful that convergence in FDI behavior will be evident as well.

My final point is that everything is based on the idea that things will go forward without major upheavals. In other words, if things remain peaceful enough and open enough and there is no major rupture, the forces of convergence will be the dominant forces of the era.

There are many things that could go seriously wrong. For example, making the war on terror the centerpiece of our thinking shows a profound misunderstanding of the fundamental forces that shape the world. A more traditional problem is that the world economy had difficulties in the twentieth century absorbing the rising powers. There were two World Wars that were related – in some way, though not in a mechanistic or deterministic way – to the challenge of rising powers. The First World War was clearly related to the competition between Germany and England, and the inability to harness that competition in a way that created a large enough comfort zone to avoid war. And I think there is little doubt that the competition with Japan was the underpinning of the war of the Pacific in World War II.

These are sobering facts, because we are facing a major rebalancing of global power, and it is very difficult for that process to happen smoothly.

Things are prickly even in matters concerning emerging-market transnational corporations (TNCs). Very specific, small transactions in a very large economy can already generate high levels of anxiety. There is almost an inability to think from the other person's perspective, which is the real danger when trying to understand your competition or to avoid war.

Another huge risk for the planet is environmental, namely the threat of a cascading effect producing profound environmental crises. Already in 2006 – this is just a minor blip – we saw droughts all over the world. In the main wheat-producing regions we saw wheat prices soar in October 2006 (for example, half the Australian crop was lost); there were major droughts throughout Asia; and there were major water stresses in the United States – probably all related to the global signal of climate change. There is more of that to come. So far we have done a miserable job of handling the energy transition, the water transition, climate change and so on. These are of first-order geopolitical significance. While it seems strange that they could really derail global growth or global convergence, it is possible that they will – not because the practical solutions do not exist, but because we might not take them.

We need to think about the dangers. But we also need to realize that, if we are successful in what we want to achieve in global development, we are talking about the biggest change of global society and reorientation of power in economics in at least 250 years. Today, we are talking about one of the very important transmission belts of that change. From that perspective, I think this is an extraordinarily important book.

NOTES

1. Author's calculations based on Maddison (2001) and United Nations (2005).
2. As developing countries benefit economically from FDI, they inturn engage in outward FDI with less-developed countries.

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