

Foreword: The Asian Miracle and its Implications

Lawrence Summers

The topic of this book is well chosen. No other event is as important today as the rise of Asia – centered on China and followed by India. To better understand how miraculous it is, a comparison with other important events of all times is in order.

The eighteenth-century industrialization and modernization era was called the Industrial Revolution because it introduced ground-breaking changes. At the beginning of that revolution, living standards in Europe were less than twice higher than in Athens 2,000 years earlier. Yet, because of the Industrial Revolution, within a single human life span (then only about 40 years), it was possible to imagine that living standards would increase by 50 per cent. As the revolution spread to the United States, it became possible to envision that within a single human life span, living standards could increase by as much as a factor of four or five. What is happening in Asia today is much more spectacular. At a 6.5 per cent growth rate of per capita living standards (which is less than the average of the last ten years for China), living standards rise 100-fold within a single human life span! They rise more than living standards have increased in the United States since the country gained independence in 1776. And this is not an isolated event affecting a few people in some niche of the world. This is an event affecting a third or more of humanity, if one takes into account the populations of China and India and looks to the remainder of Asia.

An economic event with such a dramatic increase in living standards of a third of humanity is likely to exceed the impact of either the Renaissance or the Industrial Revolution. When historians record the history of our time 300 years from now, current developments in Asia – which change the lives of so many people, so quickly and have numerous ramifications for the global system – will be considered the most important story of the day. Developments in the Middle East – the region's conflicts, troubles and achievements – will probably be considered the second story in its importance. And the end of

the Cold War – the 50-year struggle between the two economic and political systems – will be assigned only third place in contemporary history.

The Asian miracle should engage anyone concerned with development. Traditionally, discussions on development refer to the ways affluent societies can assist developing countries in order to achieve better socioeconomic outcomes improving people's lives. Even though such discussions are relevant in respect to Asia, the focus on assistance is not sufficient. The development of Asia is so significant, and the impact of a growing Asia on the global economy is so substantial, that many other questions need to be raised. Let me highlight here three major aspects of what the rise of Asia means for the world – indicating the issues rather than providing answers.

GLOBAL FLOW OF CAPITAL

We live in a world where mature industrialized economies with high standards of living grow much slower than emerging economies with far lower standards of living. If you ask an economist who lived on Mars for the last two decades about the direction of the capital flow under these conditions, he or she would most probably say 'from mature core to the rapidly growing periphery.' Wrong! The present-day net flow of capital is from emerging Asia to the industrialized core. And this trend is likely to continue – on an expanding scale – in the future. The most rapidly growing China is the world's largest lender, while the United States, the world's largest power, is the greatest borrower. This paradox should engage us because it is not clear how sustainable it can be and how desirable it is even if it can be sustained.

The numbers are impressive. China has accumulated a trillion dollars. Developing Asia has accumulated \$2 trillion. The vast majority of this capital is held in US treasury bills or similar instruments at a less than 2 per cent yield in real terms or close to zero in local terms, if the growth of those societies and the likely capital appreciation are taken into account. Two trillion dollars which are invested at no return signal lost opportunities for productive investment and for productive consumption – for enabling people to enjoy the present and the fruits of prosperity in the future. To be sure, adequate reserves for insurance are an imperative. As US secretary of the treasury, I advocated the accumulation of reserves to avoid a liquidity crisis similar to the one experienced by Asia a decade ago. But \$2 trillion dollars in reserve certainly constitute a paradox.

Contemporary tendencies in the global flow of capital also raise a long-run question about recipients of this capital. How long can the United States run a deficit as large as it is running? Will the confidence to lend still be there as the \$2 trillion turn into \$4 trillion? Will there be a willingness to accept exports

from Asia and imports to the United States which are concomitant to this large capital imbalance? How can this issue be best addressed? This is the first series of questions posed by the rise of Asia.

GLOBAL FLOW OF GOODS AND SERVICES

The second issue is that of profound distributional consequences of the Asian miracle. For the global distribution of income, the rise of China and India is by far the best thing which has ever happened. Globally, the situation of humanity is improving, and the condition of the poorest on the planet is improving most rapidly. So, citizens of China and India and other emerging nations are enormous winners from the latest developments. Moreover, those with the wherewithal to take advantage of new opportunities are also enormous winners: major financial institutions, leaders of large multinational corporations and those with the ability to create ideas or sell sophisticated products in expanded global markets.

However, there exists a vast global middle – workers from Michigan, farmers from Mexico and merchants from Morocco – for whom this phenomenon of globalization may not be favorable. This global middle does not have the capacity to be at the cutting edge of the global economy to benefit from its opportunities and at the same time cannot compete on price with labor from China or India. Of course, protectionism carries many dangers, while there are enormous consumer benefits from the rise of Asia. But the question about the impact of Asia's miraculous emergence on the vast global middle and how it should be cushioned is neither well researched nor resolved. In the meantime, the impatience of the polity in many places is increasing.

GLOBAL FLOW OF INFLUENCE AND POWER

In defining the third question let me start with the historical observation that whenever there is an important change in the distribution of relative economic strength, the geopolitical consequences are profound. *Dangerous Nation* by Robert Kagan (Knopf, 2006) describes how people who lived in Mexico, the Caribbean, the Philippines or west of the Mississippi River between 1607 and 1898 perceived the United States. Kagan's book is quite sobering for an American. History is less benign and more complex than standard US history textbooks may suggest. And it teaches some lessons on how narrow minded responses to rising economic power bred frustration and conflict.

China, India and other developing countries make impressive efforts to understand the US and European perspectives as well as perspectives of international organizations. However, no effort of comparable intensity goes on within the United States, Europe and international organizations to grasp the hopes, fears, aspirations and worries of these societies which are so rapidly transforming. Returning to the previous point, the rate of change in Asia is far greater than anything that ever happened in the United States. And the present-day impact of Asia on the United States and the industrialized world is enormous, involving a particularly dramatic effect on the global middle. That is why this subject is going to dominate the history of our time and why we owe it thoughtful and careful consideration.

IMPORTANCE OF ECONOMIC RESEARCH

This book is a result of economic research conducted by scholars affiliated with the Global Development Network (GDN). I am an ardent believer in research and its capacity to contribute to understanding the present and anticipating the future. A few anecdotes would highlight its importance.

In 1995, soon after President Ernesto Zedillo, the current chair of the GDN Board of Directors, came to power in Mexico, his country faced a very severe financial challenge. To contain the crisis, the United States and the International Monetary Fund were engaged in lending money to Mexico on an extraordinary scale, tens of billions of dollars. When I met with President Zedillo – upon President Bill Clinton’s request – to assess the situation and share the perspective of the US administration, our conversation went much beyond the scheduled meeting items. The President of Mexico started discussing a variety of research which had been done on the economics of information, adverse selection, moral hazard and what it meant for credit rationing and the possible impacts on increasing interest rates. So, on a dark day of financial crisis, the president of that nation was profoundly concerned about results of economic research.

Some time later there was another financial crisis in China, and I was sent by President Clinton to meet with the then Chinese Prime Minister Zhu Rongji. At some point in the discussion, Mr. Zhu said: ‘Tell me, Professor Summers, who is correct – Stanley Fischer or Joseph Stiglitz – in assessing what should be done with monetary policy in the context of a crisis?’ He proceeded to tell all about his previous meeting with [the Nobel Prize Winner in Economics] Merton Miller and Miller’s views on issuing put options with respect to the *renminbi* and whether they would diminish effectiveness. More recently, I spoke to a student who traded in environmental permits for carbon on the

European exchange, and he discussed a variety of theories on how the relative prices of carbon permits in Europe would move with carbon permits in China. And again I realized that the world has been changed by the results of economic research.

To give one more example, it is now a commonplace idea that the reason people go hungry is because they lack the wherewithal to *buy* food – not because there is no food. This is now an insight which informs all efforts to respond to famines. When I went to a graduate school 30 years ago, this was not a common belief. At that time, it was thought that the world needs to figure out how to produce more food. And if the world figures out how to produce more food, famines will disappear. This change in the perspective is also a result of economic research. Therefore, we should not underestimate the importance of intellectual debates which identify factors of success or failure: the incentive schemes that determine whether teachers show up for work, the resource allocation schemes that determine whether syringes are available to provide immunization, questions about pricing of water which are literally matters of life and death for hundreds of people around the world.

This book assembles social science research on the most important topic of our time. It is particularly helpful that GDN brings out the voices of scholars from the developing world – those who are underrepresented in contemporary literature and whose views are invaluable for managing the global economy. Every phenomenon has two sides – positive and negative, drivers and limitations. By analyzing the two sides of the rise of China and India, this book should enrich our understanding of the Asian miracle and contribute to its balanced interpretation.