

THE WORLD ECONOMY TOWARDS GLOBAL DISEQUILIBRIUM

American-Asian Indifference And European Fears

INTRODUCTION AND MAIN CONCLUSION

In the first five years of this new century a new era is being ushered in the world economy. During the course of this new era Asia (led by China and India) will become the leader in world growth and the globalization process.

An impressive shortening of the length and an acceleration in the passing of eras seem, therefore, to characterise this new scenario.

For almost two thousand years man has experienced eras lasting about 500 years each. In the last century two different eras can be distinguished, each one of them lasting around 50 years. At the end of the first 5 years of this new millennium, however, a completely new era seems ready to appear.

This kind of acceleration implies that, while in the previous eras, twenty and then at least two generations were involved in the change over, under these new conditions we seem to be facing a case of overlapping generations because the behavioural adjustment cannot be spread over several generations and over a long period of time, but it must be faced at the same time by sons, fathers, grandfathers and maybe even by great-grandfathers. This is what we aim to stress as a premise.

In Chapters 1 and 2, we focus on the last era we lived through during the second half of the 20th century and we try to single out the major foundations of the world economy within this period which do not exist any longer.

During the present era 2000-2005, China's average growth rate has been approximately 8/9% per year, while US growth has been 3 to 4% and the Eurozone rate of growth has been around 1%.

If we project these rates in the long run and we consider Purchasing Power Parity GDP, as we do in Chapter 3 then, after 2020, the new G8 will consist of China as its leader, followed by United States, India, Russia, Japan, Brazil and Korea.

The major European countries will disappear from the world's leading economic group.

A new world axis will be established in the world economy passing through the Pacific between North America and Asia and, for the first time in history, Europe, the Atlantic Axis and the Mediterranean areas will be marginalized, becoming residual areas on the world's economic map.

A temptation could lead the USA to forget about Europe, unable to achieve higher growth rates, and to tighten their relationships with China and the rest of the Asian continent.

However, this temptation contains a great risk for them and for the rest of the world. Indeed, US growth could continue only with the condition that the huge US Foreign Deficit (over 6% of GDP and over 700 billions of dollars a year) will be financed by Chinese savings. In this case, China will hold an ever-increasing share of the US Foreign Debt which began as the 5% held in the year 2000 and continued with the slightly below 20% already reached in 2005. Consequently, this 20% will become 30, 40, 50%!

Therefore, the world economy (see Chapter 4) appears to have, in the east, an Ant (China), in the west a Grasshopper (the USA) and, in the middle, Europe as a declining Sleeping Beauty.

On the one hand, the problem in Europe is how to awaken the European economy, that is which macro economic policy and structural reforms can produce higher growth and provide better chances to remain a leading economic area of the world (see Chapter 5).

On the other hand, the problem in the world economy is how to find a solution to the US Deficit without depressing the US and the rest of the world's economies. To this aim, the book tries to run several econometric exercises to find some good clues as to how to solve the problem that the world is facing these years. This is the content of Chapter 6.

First, a measure of how far a dollar devaluation has to go to bring the US Foreign Deficit below a sustainable 3% of GDP a year is provided. The answer is a

dollar/euro rate of 1.90, a yuan/dollar rate of 5 and a yen/dollar rate of 61! ...with the rest of the world starving, due to very low or even negative rates of growth. And in this case US growth will be pushed downwards, as well.

Then, an appropriate internal economic policy mix to push European growth up, at given international conditions of world demand and current exchange rates, is proposed and verified.

The exercises prove that higher and sustainable European growth rates are possible, but this event alone cannot solve the world's imbalances.

Therefore, since we face a new era in which long run perspectives do not imply real and financial equilibria, given the actual exchange rate system and the actual world governance in terms of international institutions, the analysis proposed in this book puts the problem the other way around: which exchange rate system and which new world governance plan can give the world economy equilibrium in the long run with sustained growth across the continents? Or, does a positive sum game for each area (and obviously for the overall world economy) exist?

The final answer is a yuan appreciation of 40% with respect to the dollar and 60% with respect to the euro, implying a dollar-euro parity, in perspective. China's growth rate could be negatively affected but it can be proved that an internal push leading to higher domestic consumption, i.e. a higher standard of living for the Chinese population, can be obtained at even higher rates of growth, producing, in the long run, real and financial equilibrium in the world economy.

In terms of World Governance, this implies that market rules must be applied and respected in the goods and services markets as well as in guiding exchange rates. Globalization implies a new WTO and a new IMF. Entering the first should at least imply a road-map which leads to the second.

However, each single continent could be attracted by a purely egoistic and myopic approach. In fact, on the one hand, its own performance and perspective could appear even better than those implied in the global equilibrium scenario, even if they proved to only be an illusory achievement within a framework of world disequilibrium. On the other hand, each single continent or country may believe it would be better off not

to take economic policy decisions within a framework of world coordination and common responsibility in this new world governance and/or by not taking the risks that certain decisions could produce in its own domestic political and social environment.

Therefore, in chapter 7 we try to focus on each single continent's egoistic interest. Although we previously compared the different alternatives with respect to a global equilibrium target, there we compare the different alternatives with specific reference to the economic, political, social and geographical framework of each continent or country, whether or not compatible and coherent with the long-run equilibrium of world economy.

The result is that the solution of a general exchange rate realignment and both China and Europe's domestic demand push is not only a solution to give real and financial equilibrium to the world economy from a global point of view, but also represents the *best solution* for each single continent or country from their egoistic point of view without any respect to an aim of world general equilibrium.

Finally, in Part III, chapter 8 to 11, we use Italy as a case study to show how a single country's agenda has to be coherent and may be coordinated with a single continent's agenda, i.e. how a member of the European Union and, better, a member of the Eurozone needs to coordinate its economic policy within the Union's economic policy. But then, we wish to stress the need for a single continent's agenda to be coherent and coordinated within a world's agenda, i.e. how to awake Europe to maintain its role in the world economy and contribute in making globalization a positive outcome for everyone.