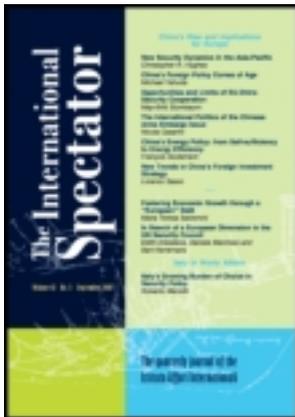


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Crying Wolf Again? The Decline of Western Economic Influence after the Great Recession

Matthias Matthijs

Since the turn of the millennium, scholars and pundits have been musing over the decline of the West. The disappointing US military invasions in Afghanistan and Iraq, together with the subprime mortgage crisis, seem to be evidence of an abrupt end to America's 'unipolar' moment. In Europe, the sovereign debt crisis has amplified Europe's long-term structural economic problems and laid bare the fragile institutional foundation on which the Economic and Monetary Union was built. At the same time, the BRICs and other emerging economies have been growing at unprecedented rates. Those same analysts see a 'decoupling' in the world economy: the developing economies pulling the world out of recession, while the advanced industrial economies are unable to solve their domestic difficulties. So to them, the events of the past five years signify the beginning of the end of Western influence, eventually leading to a more complete rebalancing of the world economy's current 'Western' system of governance. This article argues instead that the West still has a significant edge when it comes to most critical factors that determine long-term economic growth potential, including technology, innovative capacity, research and development, investment climate and education. Furthermore, the transatlantic economy is less vulnerable than the rest of the world to outside economic shocks and might eventually prove more capable of reform than many expect. The current malaise in the transatlantic community might therefore prove once again to be more cyclical than structural. Relying on linear projections, many are 'crying wolf' again, too loud and too soon.

Keywords: decline, decoupling, West, Rest, transatlantic economy, world economy

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In the end, of course, the Soviet and Japanese threats to American supremacy proved chimerical. So Americans can be forgiven if they greet talk of a new challenge from China as just another case of the boy who cried wolf. But a frequently overlooked fact about that fable is that the boy was eventually proved right. The wolf did arrive – and China is the wolf.

Gideon Rachman¹

For the past sixty years, at the turn of every decade, scholars and pundits on both sides of the Atlantic who observe or warn against American and Western economic decline, resurface.² Their idea that “the West” is falling behind “the Rest” is back in vogue for a while, until events catch up with them and the facts no longer seem to support their claims.³ Declinism then goes out of fashion, only to re-emerge reinvigorated ten years later.⁴

Every such ‘declinist’ period coincides with either a transatlantic recession or economic slowdown, a diplomatic rift between Europe and the US, a military quagmire, or a substantial geopolitical setback for NATO or the Western powers. Consider Mao Zedong’s victory over the Kuomintang in China in the late 1940s and the Korean War in the early 1950s; the Sputnik challenge of the Soviet Union in the late 1950s; the social unrest and Vietnam War protests in the late 1960s; the twin oil shocks of the early and late 1970s; Japan’s challenge, malaise and the long recession of the early 1980s; ‘eurosclerosis’ in the late 1980s and the post Gulf War I recession of the early 1990s; the dotcom bust, 9/11, the wars in Afghanistan and Iraq, and the recession of the early 2000s; and now the global financial crisis, the euro crisis and the meteoric rise of countries like China, India and Brazil. The aftermath of each perceived Western failure is rife with declinist drumming, complete with confident proclamations that “this time it’s for real”,⁵ that the days of the West are numbered, and that the centre of gravity in the world economy is inexorably shifting from the Atlantic towards the Pacific and Indian Oceans.

So, in light of recent declinist declamations, and in keeping with the decadal cycle, the compulsory question to ask, yet again, is: are things *really* different this time?⁶

¹ Rachman, “Think Again”, 59.

² One could even argue that this was already the case before World War II. There was a lot of academic discussion in Britain during the second half of the 19th century about the rise of other powers. But perhaps the most famous example during the interwar period was Oswald Spengler’s *Der Untergang des Abendlandes* (translated as *The Downfall of the Occident* or simply *The Decline of the West*), published in the summer of 1918, in which he rejected the European-centric view of history.

³ Ferguson, *Civilization*; Kupchan, *No One’s World*.

⁴ See, for example, Joffe, “Declinism’s Fifth Wave”, 95–8, <http://www.the-american-interest.com/article.cfm?piece=1170>.

⁵ Rachman, “Think Again”, 59.

⁶ To borrow the title from Reinhart and Rogoff, *This Time is Different*.

There are certainly enough prominent analysts to make the case in favour of the Rest.⁷ Among them, Niall Ferguson is the most outspoken proselytizer of Western decline. He argues that we are currently experiencing “the end of 500 years of Western predominance”, and that the 2008 financial crisis has to be “understood as an accelerator of an already well-established trend of relative Western decline”.⁸ For Ferguson, the critical question is not whether there will be a clash between East and West, but whether the latter will “tip over from weakness to outright collapse”.⁹ In his 2008 book, *The Post-American World*, Fareed Zakaria observed America’s power to be in steep relative decline and claimed that the rest of the world’s rapid rise in recent decades came courtesy of the liberal values the United States had exported around the globe. Zakaria believes that the US will continue to dominate the world in terms of military power, but that it now has to compete head-to-head with China and India for economic and cultural influence.¹⁰ Charles Kupchan sees a broader “democratic malaise” in the West, with globalisation having engulfed the transatlantic economies with a “crisis of governability”, while emerging markets are forging ahead.¹¹ Gideon Rachman makes the point that decline is for real this time. According to Rachman, America and its traditional allies in the West – including Britain, France, Italy and Germany – are rapidly tumbling down the economic league tables while China’s rise is already challenging American influence worldwide.¹² Even in Singapore, Kishore Mahbubani refers to the “Western financial crisis”, leaving no doubt about who is to blame for the Great Recession. He notes that Western leaders are unaware of how “incompetently” they are now viewed by the rest of the world. Mahbubani believes that, unlike him, most Asians are simply too polite to tell them the truth.¹³

Most of these declinist authors see the current period as significantly different from the others because of the co-existence of a combination of structural factors: the West’s rapidly ageing populations, the inability of mature democracies to achieve consensus on economic reform, and the fact that the rest of the world has fundamentally changed, their embracing of markets and globalisation having put them in a qualitatively different growth league this time around.¹⁴

⁷ For a relatively early overview of the current wave of ‘declinists’ (published in 2007), see Kitfield, “The Decline Begins”.

⁸ Ferguson, *Civilization*, 308.

⁹ *Ibid.*, 323.

¹⁰ Zakaria, *The Post-American World*.

¹¹ Kupchan, “The Democratic Malaise”.

¹² Rachman, “Think Again”.

¹³ K. Mahbubani, “Asia has had Enough of Excusing the West”, *Financial Times*, 25 January 2011.

¹⁴ See D. Moisi, “The Sun goes down on the West”, *The Guardian*, 18 February 2010. According to Moisi, the Western world will represent only 12 percent of the world’s population by 2050 – with Europe accounting for just 6 percent.

There are two schools of thought that counter the now widespread sentiments of Western decline. One group, mostly made up of American neoconservatives, either denies relative economic decline altogether, arguing that it is nothing more than a myth based on misplaced fears,¹⁵ or claims that decline is a choice – not beyond the West’s control to reverse – and blames US President Barack Obama’s ‘new liberalism’ for deliberately bringing Western ascendancy to an abrupt end.¹⁶ The second group consists broadly of China pessimists, who see Asia’s current growth miracle as a short-term mirage that heavily relies on the West for its success.¹⁷

The argument in this article is more nuanced in its scepticism of the immediacy or even inevitability of Western decline. Despite the recent economic ‘catch-up and convergence’ of the Rest, which has effectively led to a significant shift in share of world GDP from the West to the Rest, the West still has a significant edge when it comes to GDP per capita as well as the factors that determine long-term economic potential, such as technology, research and development, trade in services, the capacity to innovate, investment climate and education. More importantly, looking at that other aspect of economic power, international economic legitimacy – manifested both in its management of international economic regimes and the appeal of its economic ideas – the West will likely remain the dominant player in the global economy. Add the fact that the transatlantic economy is less vulnerable than the rest of the world to outside economic shocks, and will likely prove more capable of deep economic reform than many analysts expect, the current malaise in the transatlantic community might prove, once again, to be much more cyclical than structural.

The article is divided into six sections. Section two will briefly assess the recent transatlantic economy’s performance and compare it with the emerging economies’, illustrating the rapid shift in short-term economic power away from the West. The third section will look at the long-term factors that will keep the transatlantic economy in the driving seat of the world economy for the foreseeable future. The following two sections address the enduring Western influence in international economic institutions and the continuing power of Western economic ideas, respectively. The second to last section discusses the West’s vulnerability to economic shocks relative to the Rest, along with its prospects for further economic integration and reform. This is followed by the conclusion.

Recent economic performance: the West vs. the Rest

Even though there is still significant disagreement on many aspects of the 2008 global financial crisis, the broad sequence of events that led to the crisis is now

¹⁵ Kagan, “Not Fade Away”.

¹⁶ Krauthammer, “Decline is a Choice”.

¹⁷ See, for example, Gilboy, “The Myth behind China’s Miracle”, and Babones, “The Middling Kingdom”.

well known.¹⁸ It all started with the bursting of the credit bubble in the US housing market in 2007. Once it became clear how a “global inverted pyramid of household and bank debt” was built on a narrow range of feeble American sub-prime mortgages, the “debt balloon started to deflate, at first slowly, [but] ultimately with devastating speed”.¹⁹ Banks soon stopped lending, both to each other and to their private customers, which caused a credit crunch and put an astonishing amount of pressure on the financial sector. In effect, the entire world had become the chief creditor to the US household sector by 2007, and when the American housing bubble burst, everyone’s collective exposure to that credit risk – and to each other – helped to create the financial market contagion. Stock markets plunged, and the financial crisis soon translated into a massive slide of the real economy, leading to falling output levels and rapidly increasing unemployment.

Governments soon stepped in to rescue their banking systems and guaranteed most of the deposits in their banks. Central banks slashed interest rates to close to zero, and budgetary authorities – in haste – put together fiscal stimulus packages of a magnitude unprecedented in peacetime. However, the world would be unable to avoid its first global contraction in output since World War II. In 2009, the world economy as a whole shrank by 1.1 percent, with the advanced economies contracting by 3.4 percent, while emerging and developing economies grew at a scant 1.7 percent, well below their much higher potential growth rates.²⁰ As Figure 1 illustrates, economic performance varied significantly across countries: China barely slowed down at all in 2009, India and Indonesia maintained growth rates of around 5 percent, and Brazil had a mild recession while Russia’s was very deep.²¹ Compared to the US, Britain and the three main eurozone economies (Germany, France and Italy), however, all emerging countries have rebounded much faster in 2010 and 2011. This would suggest a real decoupling in the world economy: for the first time, emerging economies seem to rely less on the West for their economic performance than in the past.

Figure 2 shows the significance of this recent divergence in economic growth rates.²² While the economies of the US, Canada and the European Union together still counted for just over 50 percent of total world GDP in 2000, that share rapidly fell to 47.3 percent in 2005, 41.8 percent in 2010, and is (based on IMF predictions) expected to drop further to 37.6 percent in 2015. To some extent, similar trends of Western decline were under way during the 1980s and 1990s. But during

¹⁸ For an overview of the recent literature on the global financial crisis, see Lo’s, “Reading about the Financial Crisis”.

¹⁹ Skidelsky, *Keynes*, 4.

²⁰ IMF, *World Economic Outlook*, 169.

²¹ Of course, the significant downturn in Russia was mainly due to a collapse in oil prices in response to the global financial crisis at the end of 2008, which actually underscores a later point in this article about the BRICs’ substantial vulnerability to outside economic shocks.

²² The “West” is defined as the United States, Canada and the 27 member countries of the European Union. The “Rest” is literally the rest – or all the other countries – of the world economy.

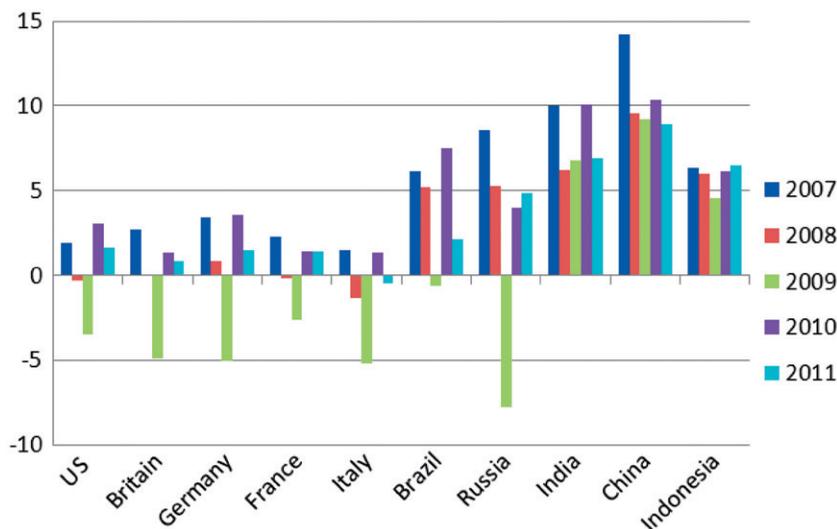


FIGURE 1. Recent growth rates of the world's major economies

Source: IMF, *World Economic Outlook 2012*, <http://www.imf.org/external/pubs/ft/weo/2011/02/weodata/download.aspx>.

the 1980s Western decline was reversed by the unexpected collapse of the Soviet Union and the subsequent nosedive of the former Soviet economies, which quickly gave the edge back to the West. During the 1990s, decline was all but unnoticeable, given the technology boom and the 'new economy' miracle combined with the peace and prosperity of the Clinton–Greenspan years. One can never rule out a short-term implosion of Asia's economies, but from a pure share-of-world-GDP point of view, Western economic decline does seem real this time, while the fast-growing share of the Rest is indisputable.

But ultimately, what is it that determines a region's influence in world economic affairs? Even though the above data paints a sobering picture about the economic size of the West versus the Rest, economic size does not necessarily translate into the components that undergird global economic influence and power. The argument put forward here is that we need to look beyond headline data and short-term growth performance, and focus on indicators of long-term growth potential as well as on aspects of economic legitimacy, such as influence over international institutions and the capacity to generate and put into practice one's own economic ideas.

Transatlantic economic 'staying' power: short-term vs. long-term

Daniel Hamilton and Joseph Quinlan note that the position of Europe and North America in the world economy has been changing "from one of

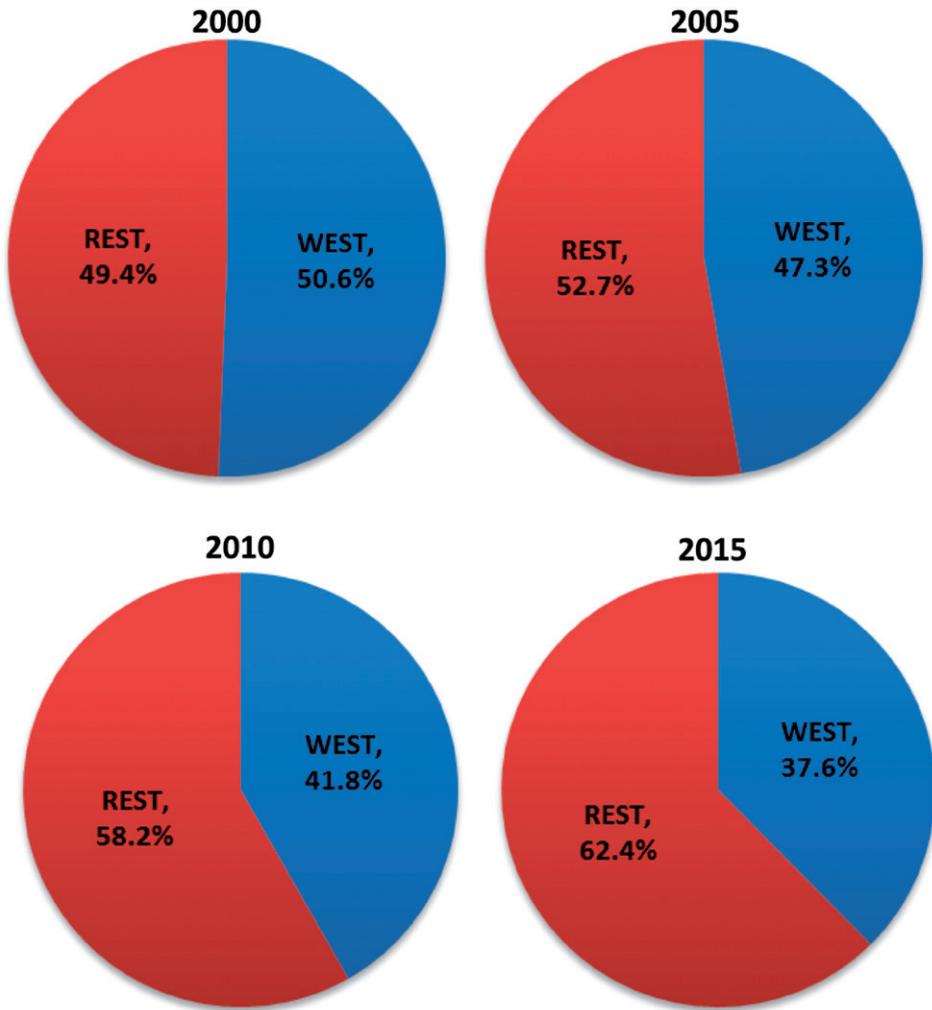


FIGURE 2. Relative decline of the West and rise of the Rest (percent of total real world GDP)
Source: Calculated from IMF Database, *World Economic Outlook 2012*, <http://www.imf.org/external/pubs/ft/weo/2011/02/weodata/download.aspx>.

preeminence to one of predominance – still considerable, but less overwhelming than in the past”.²³ For them, the main strength of the West is that, despite the aftershocks of the global financial crisis, they remain much more integrated than any other region in the world.

In the longer term, as post-neoclassical endogenous growth theory expounded in the 1990s, growth will depend on factors like human capital, innovation, technology, research and development, investment climate issues and the ease of

²³ Hamilton and Quinlan, *The Transatlantic Economy 2012*, v.

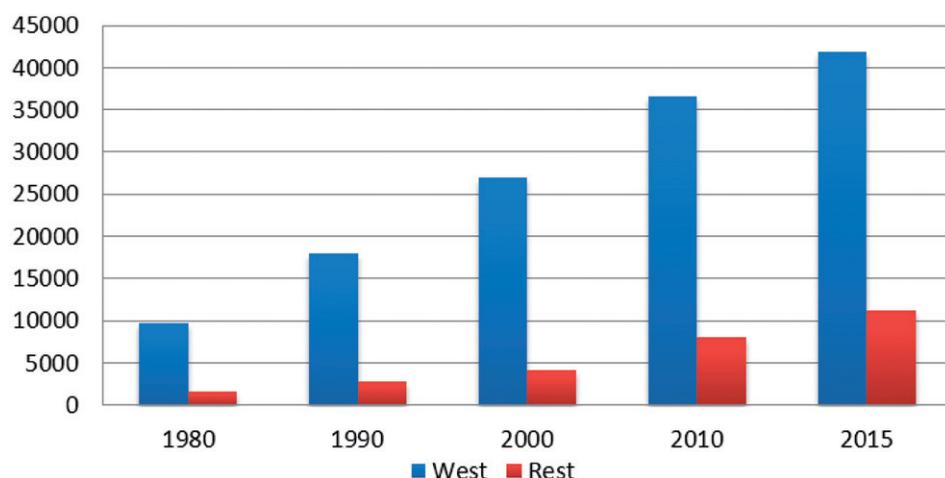


FIGURE 3. Per capita GDP (in constant USD)

Source: Calculated from IMF, *World Economic Outlook* (2012 database), <http://www.imf.org/external/pubs/ft/weo/2011/02/weodata/download.aspx>.

doing business.²⁴ As Figure 3 shows, one gets a very different picture of catch-up and convergence by looking at recent growth in GDP per capita terms. While the Rest has clearly overtaken the West in absolute terms (Figure 2), it is a long way from catching up to the West in terms of income per person, with GDP per capita in the West predicted to be close to USD42,000 in 2015, compared to an average of just USD11,000 – just over a quarter of that for the Rest of the world economy.²⁵ This point is important, since a country's overall economic welfare – for which GDP per capita is an imperfect but close proxy – leads to a healthier and better educated workforce, more responsive institutions, and better macroeconomic policies, all factors that are crucial for long-term economic success. And in all the domains just mentioned, the transatlantic economy is still far ahead of everyone else, and therefore more likely than not to remain at the edge of the world economic frontier in the coming decades.

The European Union and the United States continue to lead in the field of innovation. Hamilton and Quinlan note that the transatlantic economy is home to 63 percent of the world's top R&D companies, 58 percent of all global R&D, and has 18 of the top 20 'knowledge regions' in the world.²⁶ They argue that cross-national innovation has become more important over the past decade as

²⁴ See Aghion and Howitt, *Endogenous Growth Theory*.

²⁵ Even though income inequality has been rising quickly in the West, which will make it more challenging to maintain active welfare states, the West's levels of inequality are well below levels seen in the Rest, as measured by the GINI coefficient. See, for example, the introduction by Berger *et al.*, *The Inequality Puzzle*.

²⁶ Hamilton and Quinlan, *The Transatlantic Economy 2012*, 21–3.

multinational firms are sharing risks, trying to tap into the human talent pools of many different countries, and are setting up joint ventures, strategic alliances, mergers and acquisitions. They also find that transatlantic flows in research and innovation are by far the most intense between the two international partners.²⁷ Europe and North America are home to a total of 87 of the world's top 100 research universities.²⁸ As for firm-level technology absorption, all the leading transatlantic economies are in the top 25, while emerging markets like India (39th), Brazil (46th), China (60th), Indonesia (64th), Argentina (93rd) and Russia (119th) seem to be trailing.²⁹ As for technology, all main economies of Europe and North America are in the top 20, while emerging markets are following well behind, for example Brazil (42nd), China (56th), India (58th), Russia (59th) and Indonesia (65th).³⁰

One of the main channels through which technology transfers happen in today's global economy is foreign direct investment (FDI). The transatlantic economy is the destination of 57.8 percent of the world's inward FDI and the source of 72.8 percent of the world's outward FDI, and the great majority of these capital flows are actually between Europe and North America.³¹ The main determinant of a country's success in attracting FDI is its investment climate or business environment. The *Doing Business* indicators of the World Bank – which take into account factors such as how easy it is to start and close a business, get credit, pay taxes, register property, enforce contracts and trade across borders – place most transatlantic economies in the top 30 (with the exception of Spain at 44 and Italy at 87), while most emerging markets are again way down in the rankings (China 91, Russia 120, Brazil 126, Indonesia 129, and India 132).³²

Legitimacy

Western influence over international institutions

Yet, economic power by itself, as measured by absolute GDP, income per capita, investment or technological progress, is not enough to wield influence over the

²⁷ *Ibid.*

²⁸ Times Higher Education, "World University Rankings", <http://www.timeshighereducation.co.uk/world-university-rankings/2011-2012/top-400.html>.

²⁹ World Economic Forum, *The Global Information Technology Report 2010–2011*, 378.

³⁰ Economist Intelligence Unit, *E-Readiness Rankings: 2009*, <http://graphics.eiu.com/pdf/E-readiness%20rankings.pdf>.

³¹ Hamilton and Quinlan, *The Transatlantic Economy 2012*, vi.

³² World Bank, *Doing Business: Measuring Business Regulations*, <http://www.doingbusiness.org/rankings>. A very similar picture is painted in the World Economic Forum's *Global Competitiveness Index*, <http://www.weforum.org/reports/global-competitiveness-report-2010-2011-0>. Here most European countries again rank among the top 20, while with the exception of China (26th), the other leading emerging economies lag further behind in the table (Indonesia 46th, Brazil 53rd, India 56th, Mexico 58th and Russia 66th).

world economy. Given the speed of economic integration since the end of World War II, there remains a strong need for global collective action to establish and maintain an open world economic system. Today's international institutions in charge of the management of the global economy – the International Monetary Fund, the World Bank and the World Trade Organisation (successor to the GATT) – were all founded under the leadership of the United States, with strong European support, and by any historic measure have been extraordinarily successful. The birth of those international institutions can best be explained by applying Charles Kindleberger's theory that only a hegemonic power would see it in its own enlightened self-interest to bear the burden of providing global public goods.³³ Kindleberger saw hegemonic stability as the only way to avoid the problem of collective action (the chronic undersupply of global collective goods) which usually comes with international economic regimes. But given the changing world economic landscape in the 1970s, with the rise of Japan and rejuvenation of the European economies leading to the relative decline of the US within the West, a US-friendly coalition of Western states (plus Japan) has maintained those regimes, a trend which has continued after the end of the Cold War.³⁴ Does the current rise of the emerging economies mean that the West will gradually lose its grip on those institutions?

So far, there are few signs that this might be the case. First, it is important to note that none of the emerging economies want to substitute the current 'Western' institutions with their own variants. For example, China joined the WTO in 2001 and Russia joined in early 2012, underscoring the fact that there are major benefits from such membership. The main interest of emerging countries like China, Brazil and India is to increase their share of the votes *within* the existing institutions, not to replace them. And while there has been some shift in decision-making power from the West to the Rest, it has all been rather marginal and symbolic. The IMF is a case in point. In 2010, the Fund's board of governors, the organisation's highest decision-making body, approved a package of what they called "far-reaching reforms of the Fund's quotas and governance".³⁵ In practice, the "major realignment" meant the United States and the European Union saw their voting shares decline from 17 and 32.5 percent to 16.5 and 29.4 percent, respectively. The BRICs, with the exception of Russia, saw their share of the vote increase from 2.9 to 6.1 percent for China, from 1.4 to 2.2 percent for Brazil, and from 1.9 to 2.6 percent for India (Russia's share actually fell from 2.7 to 2.6 percent). Since all important decisions still have to be approved with a super majority of 85 percent of the votes, this is hardly what one would call a tectonic shift. Furthermore, with the replacement in the summer of 2011 of Dominique

³³ Kindleberger, *World in Depression: 1929–1939*.

³⁴ See Keohane, *After Hegemony*.

³⁵ IMF, "Factsheet: IMF Quotas", <http://www.imf.org/external/np/extr/facts/quotas.htm>.

Strauss-Kahn by Christine Lagarde at the IMF, and the succession of Robert Zoellick as president of the World Bank in the summer of 2012 by another American (even though Korean-born), Jim Yong Kim, Europe and the US have so far maintained their monopoly on running those institutions. Many observers see this as a missed opportunity, but the fact remains that the West continues to control the Bretton Woods institutions.

Of course, declinist authors will be quick to respond that since 2008 the Group of 20 is the primary international body for dealing with international economic relations and global decision-making. Of the 20 official seats at the G20 table, only 7 belong to the transatlantic community – a clear sign of waning Western economic influence.³⁶ But again, that could not be further from the truth. Apart from the common response to the financial crisis and global solidarity displayed during 2009, the G20 has been a dismal failure so far, and one of the key reasons probably is that the United States is not in the driving seat. According to Uri Dadush and Kati Suominen, “even the largest emerging economies prefer to free ride or to voice their displeasure without articulating an alternative vision”.³⁷ They note that countries like India and China actually worry about the lack of American leadership because they find it rather difficult themselves to play a significant role.³⁸ The problem with the G20 remains that there are too many members with widely different agendas and viewpoints, which sets it apart from the like-mindedness and coordination of the G7, which was led by the United States (and was, with the exception of Japan, almost exclusively a transatlantic grouping).³⁹

The power of Western economic ideas

The other dimension of international economic legitimacy is whose ideas end up governing the world economic institutions and inform domestic economic policy-making. During the 1990s, given the US’ newfound confidence after its triumph in the Cold War, Francis Fukuyama’s triumphalist “end of history” idea dominated the policy discourse in Washington: a combination of the Western ideas of free markets, private property rights, and democratic government was the unchallenged recipe for economic growth and prosperity.⁴⁰ For a while, the ‘Washington consensus’ reigned supreme. John Williamson first coined the term in the late 1980s, giving developing countries a laundry list of reforms to implement that would lead

³⁶ Those seven seats are for the US, Canada, the European Union, Germany, France, Britain and Italy (this does not include Spain and the Netherlands, who were initially invited by France to join, but have not been invited to the latest meetings).

³⁷ Dadush and Suominen, “Is There Life for the G20?”, 8.

³⁸ *Ibid.*

³⁹ One could argue that the reluctance on the part of China and India to lead is a tacit acknowledgement of their own lack of legitimacy.

⁴⁰ Fukuyama, “The End of History?”.

to faster growth – including fiscal restraint, public spending priorities, tax reform, deregulation, privatisation, and the liberalisation of interest rates, exchange rates, trade and foreign investment.⁴¹ All over the world, from Russia to Eastern Europe, and from Latin America to Africa and Asia, developing countries were implementing packages of neoliberal reforms.

But given the numerous financial crises in emerging markets during the 1990s and early 2000s, the fast growth of the BRICs during the first decade of the 21st century (China in particular), and the ‘Western’ financial crisis of 2008, with the West struggling to regain its footing, many quickly thought the Washington consensus forever banished to the dustbin of history. An alternative ‘Chinese model’ of capitalism – authoritarian rather than democratic, with heavy government intervention, mercantilist rather than liberal in trade orientation, and a combination of mixed ownership and only basic property rights – seemed to have emerged as a much more attractive alternative for much of the developing world. Joshua Cooper Ramo, first came up with the term ‘Beijing consensus’ in 2004, a clear rebuff to the declining Washington consensus.⁴² To be fair to the Chinese, though, it is mainly the Americans today that talk about such a rival consensus. Authorities in China like to point out that, for them, the rest of the countries in the world should adopt the economic policy they see most suited to their particular situation, rather than follow a certain set of guidelines. So far, Beijing has had an official policy of non-interference. Given their relative dependence on the US economy, the last thing they want to do is to tout the virtues of their supposed China model, keen as they are to avoid any talk of themselves as a rival power.⁴³

One can see why the Chinese model of “you can do whatever you want” would be more attractive to leaders of developing countries than the American laundry list of tough economic reforms. But, ignoring China’s diplomatic position for a moment, is there any reality to this emerging Beijing consensus? The simple answer is no.⁴⁴ As Yang Yao has observed, China itself has been moving “unmistakably toward the market doctrines of neoclassical economics, with an emphasis on prudent fiscal policy, economic openness, privatization, market liberalization and the protection of private property”.⁴⁵ Yao further notes that Beijing is obsessed with balancing its budget and keeping inflation low, has kept purely redistributive programs to a minimum, and has privatised the lion’s share of

⁴¹ See Williamson, “What Washington Means by Policy Reform”.

⁴² “The Beijing Consensus is to Keep Quiet”, *The Economist*, 6 May 2010, <http://www.economist.com/node/16059990>.

⁴³ *Ibid.*

⁴⁴ See “China’s Capital Controls: Set the Money Free”, *The Economist*, 3 March 2012, <http://www.economist.com/node/21548943>.

⁴⁵ Y. Yao, “The End of the Beijing Consensus”, *Foreign Affairs Snapshot*, 2 February 2010, <http://www.foreignaffairs.com/articles/65947/the-end-of-the-beijing-consensus?page=2>.

its state-owned enterprises.⁴⁶ One could be forgiven for thinking that these policies follow Williamson's original prescriptions rather neatly, with a couple of exceptions such as the much more gradual liberalisation of interest rates and exchange rates, even though they are clearly moving in that direction when it comes to finance. And China is not the only one to liberalise; the others are moving that way too. Even India, a country with one of the most conservative financial authorities in the world, recently allowed a nascent market in credit default swaps and derivatives to develop.⁴⁷

So, even though there is no doubt that the West has lost its aura of competence since 2008, its economic ideas remain as influential as ever. While the IMF, under the leadership of chief economist Olivier Blanchard, has been rethinking some elements of the Washington consensus, such as the excessive focus on low inflation, the role of fiscal policy and the speed of capital account liberalisation, this is really more of an effort to tweak the consensus rather than radically change it.⁴⁸ Also, whether China's economic rise presents a real challenge to the West's idea of democratic governance with its universal appeal is doubtful at best. Events like the Arab Spring in 2011, the anti-Kremlin protests in Russia and the successful elections in Taiwan in 2012, are not indicative of an imminent shift in the direction of authoritarian government worldwide.

Transatlantic vulnerability and prospects for further integration and reform

Trade openness and economic integration with the rest of the world can be a blessing or a curse. If the rest of the world economy is growing at a healthy rate, it will pull your economy along with it. But if the countries of your main export markets are in a long recession, your home economy will suffer. Both the European Union and the United States have large markets that are relatively independent of the rest of the world. In 2005, exports of goods and services as a percentage of GDP was just 10 percent for the US and 11 percent for the EU, compared to 15 percent for Brazil, 19 percent for India, 34 percent for Indonesia, 35 percent for Russia, and 37 percent for China.⁴⁹ Furthermore, most of the trade of the US and Europe is with each another, while a significant percentage of exports from the BRICs go directly to the big Western markets. This means that, from a trade point of view, the Rest is much more vulnerable to economic shocks in the West than vice versa.

⁴⁶ *Ibid.*

⁴⁷ "Financial Innovation: Such Seething Brains, Such Shaping Fantasies", *The Economist*, 25 February 2012.

⁴⁸ O. Blanchard, G. Dell-Ariccia and P. Mauro, "Rethinking Macroeconomic Policy", *IMF Staff Position Note*, 12 February 2010, <http://www.imf.org/external/pubs/ft/spn/2010/spn1003.pdf>.

⁴⁹ OECD Statistics, *Globalisation: Macro Trade Indicators*, <http://stats.oecd.org/Index.aspx>.

The reason most emerging economies, especially China, were so successful in rebounding after the 2008 crisis was the large domestic fiscal stimuli that were quickly implemented.⁵⁰

Within the area of international trade, the main growth area is trade in services, whose potential has yet to be fully exploited. Hamilton and Quinlan refer to services as “the sleeping giant of the transatlantic economy”, with the US the largest single country trader in services and the European Union the largest services trader of all world regions.⁵¹ Specifically, the transatlantic economy continues to lead in exports of global communication services, transportation services, international travel receipts, insurance, financial services and computer and information services.⁵²

Another area of transatlantic economic worry declinist thinkers point at to make their case is the inability of Europe and the United States to reform their economies. The US has so far been unable to reform its social security system or Medicare (the public health insurance system for the elderly), while continental Europe does not seem capable of liberalising its labour markets or trimming its unsustainably generous welfare states, even in the event of a full-blown sovereign debt crisis. While this has broadly been true up until now, this is actually one area in which things might be different this time. 2012 is an election year in the United States with little prospect of real compromise between Republicans and Democrats. However, a clear victory for one party in November 2012 might clear the path for long-term budgetary reform, especially if the rest of the world keeps growing at its current fast pace. And the eurozone crisis, more than anything, has allowed Europe’s leaders to focus on a common goal. Germany showed the way in the early 2000s, at a time when most economic analysts claimed that the country was the ‘sick man of Europe’, incapable of labour market or welfare reform. Schröder’s reforms paid off handsomely for his successor Angela Merkel and, under her leadership, Germany has once again emerged as the model economy for the rest of Europe. While Europe has a long way to go, and there are plenty of reasons why the Economic and Monetary Union might not survive in its current shape or with its current membership intact, nothing like an existential crisis can have the capacity to revive politicians’ resolve to restart a formidable economic machine like the European common market. If the history of European integration of the past sixty years is any guide, there could well be reasons for optimism. However, the storm is far from over and it is not guaranteed that politics will win out over economics this time around.

⁵⁰ For example, China’s stimulus was the equivalent of close to 13 percent of GDP, compared to just below 6 percent for the United States.

⁵¹ Hamilton and Quinlan, *The Transatlantic Economy 2012*, x.

⁵² *Ibid.*, x–xi.

Finally, the rise of the Rest comes with its own significant vulnerabilities. China's growth model, for example, faces enormous challenges. Nicholas Lardy has laid bare some of the country's structural shortcomings: a growing domestic imbalance between super high savings and low household consumption, too much reliance on export markets for growth, an unsustainable real estate boom and a weak banking system.⁵³ James Riedel *et al.* also emphasized the weaknesses of China's financial system which have undermined the overall efficiency in investment allocation. Even though China is moving in the right direction, according to the authors, the road may well be long and bumpy.⁵⁴

Conclusion: the dangers of linear thinking in the 21st century

The late Tony Judt used to remind his audiences of the dangers of linear projection, arguing that it was naïve to think you could predict the future based on present economic trends. He argued that many American analysts today are making the same mistake many made in early 20th century Europe. Back in 1912, three assumptions were widely held: large-scale war between states would never happen again, the 20th century belonged to Germany, and nationalism was a thing of the past.⁵⁵ Of course, as we now know, history turned out to be quite different.

Relying on linear projections, many declinists are 'crying wolf', again, perhaps too loud and definitely too soon. There is no doubt that the transatlantic economy is in relative decline, if one solely focuses on its total share in world GDP. But if one looks beyond the short-term headlines, at those factors that determine long-term growth potential, the picture already becomes much more mixed. Moreover, the international economic institutions and economic ideas that have governed the world economy for the past sixty to seventy years are here to stay and will continue to be run by the West in the foreseeable future. Finally, if one adds the emerging economies' relative vulnerability to outside economic shocks, and assesses the prospects in the West of further economic integration and reform, it becomes hard to see why the latest wave of declinism should be any different from the earlier ones.

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⁵³ Lardy, *Sustaining China's Economic Growth*.

⁵⁴ Riedel *et al.*, *How China Grows*.

⁵⁵ See Judt, *The Future of Decadent Europe*, http://www.brookings.edu/~media/Files/rc/papers/2006/02europe_judt/judt20060210.pdf.

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