China and India in the Changing Global Economic Order [*]

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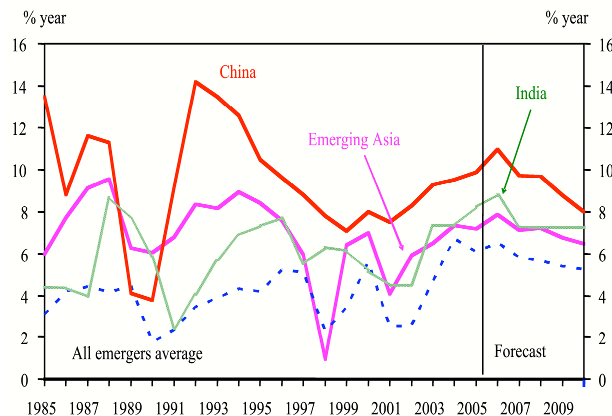
The Asia century?

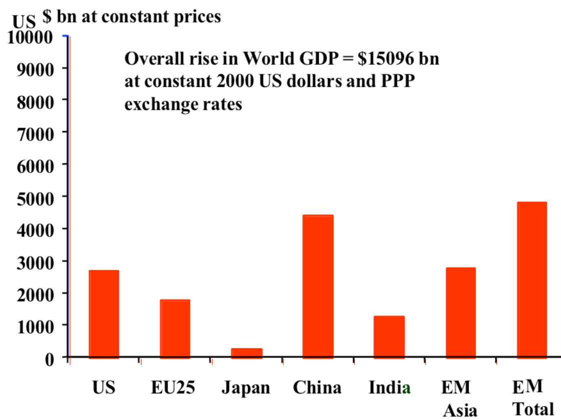
Is the 21st century going to be the Asia century, as the 20th century was the America century – and the 19th century was Europe's? Several economists and commentators[1] agree that it might be, thanks to the contribution of China and India to the world's economic growth. Even if we take long-term forecasts with necessary caution, Asia's path of economic growth over the last 25 years, if maintained, can considerably expand the region's economy – or at least some of its components.

In the last two decades Asia's economic growth has diverged widely from that of other developing regions such as Latin America and Africa. Figure 1 shows how, since the mid-1980s, economic growth in emerging Asia has been much stronger than elsewhere. These two regions include the fast-growing economies of China and India. Such growth has benefited from more trade integration with the global economy. Although the conditions for robust economic growth were set more than 20 years ago, in the case of China, and some 15 years ago for India, it has only been since mid-1990s that these two countries have started to make their mark in the world economy. As Figure 2 shows, over the period 1995-2005 China was the biggest single contributor to world GDP on purchasing power parity (PPP) basis. India also performed well, relative to both developing and developed countries.

Figure 1: Emerging markets: GDP growth



[1] They include Goldman Sachs' research team (Goldman Sachs, 2003) and OEF. The Shell report (Shell, 2005) also suggests a more prominent role for Asia in the next decades.



Sources: OEF and WDI

China stands out within the world economy, and India trails behind

With more than a billion people, China has experienced rapid economic growth during the past decades – on an unprecedented scale in economic history – thanks to a policy of reform and economic openness. Real GDP in 2005 was about 12 times the level of 1978, when Deng Xiaoping launched China on the path of economic reform (National Bureau of Statistics of China, 20006:24; Lardy, 2006:1). Since then China has enjoyed annual average growth of 9%.

Moving gradually from a state-planned agricultural economy into a global manufacturing powerhouse has helped reduce poverty. With the number of people living on a dollar per day diminishing by 170 million between 1990 and 2000, China alone has contributed more to global poverty reduction than the rest of the world put together. Its growing role in global manufacturing has benefited not only the Chinese, but also developing countries that supply Chinese factories with raw materials and manufacturing inputs. The rise of China's economic power has also improved the welfare of consumers in industrialized countries by making cheaper goods available to them and keeping a lid on inflationary pressures

Although it significantly trails behind China in terms of size, annual GDP growth and GDP per capita (Table 1), India has also been experiencing rapid change. Emerging from decades of economic insulation, the country's economy has been growing strongly with the result that vast amounts of wealth have been accumulated and the number of poor has been greatly reduced.

Table 1: China, India and OECD countries

		China	India	OECD
Economy	*Compounded annual GDP growth, 1994-2004*	*9.1*	*6.1*	*2.6*
	GDP per capita, 2004 PPP	*5,896*	*3,139*	*32,003*
	Services as % of trade, 2003	*10*	*28*	*23*
	Trade as % of world total, 2004	*5.7*	*1.1*	*63.8*
Financial system	*Nonperforming loans as % of total, 2004*	*15.6*	*6.6*	*>2.5**
Business climate	*Number of companies in Forbes 2000 list 2005*	*21*	*30*	*1702*
Education	*Science and engineering graduates (MA and PhD, 1999)*	*41,000*	*63,000*	*77,000°*
Consumer Behaviour	*Passenger cars (per 1,000 people, 2000*	*6.7*	*6.0*	*435.2*

*Notes: *Except Italy and Greece ° US only*

Source: World Bank, 2006c

The achievements of the past 15 years have raised tremendous optimism with regard to both countries, but the remaining economic and social challenges are huge. Today India has one of the largest middle classes in the world, but more than 800 million people still live in poverty (World Bank, 2006b). The income per capita has almost tripled between 1980 and 2004, growing from US$245 to US$600. China's annual income per capita has quadrupled between 1980 and 2004, from US$310 to US$1,275. Yet, although poverty rates have declined, the World Bank reported that the proportion of the population living on less than $1 a day in 2006 was about 8% of the population, or approximately 106 million people (World Bank, 2006a). Most of them live in rural areas. Compared with Korea and Taiwan (where the income per capita is currently around US$14,000) and even with Thailand (where it is US$2,600), China and India have a long way to go to improve living standards and reduce the number of people in poverty.

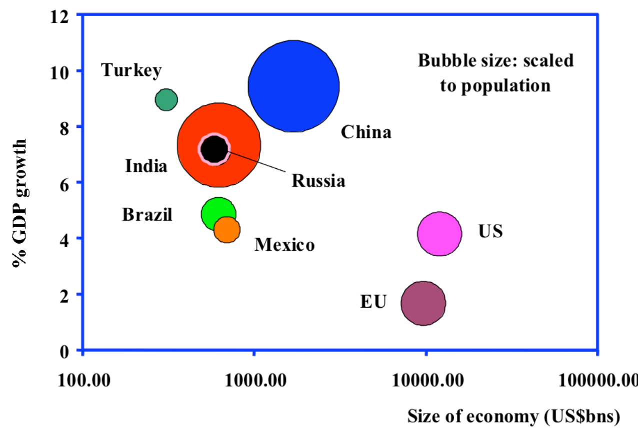
The role of China and India in the world economy

The strong expansion of the Chinese and Indian economies over the last decade leaves no doubt about their impact globally. Continued growth, especially in the Chinese economy, will have a major influence in shaping global markets over the next decade and beyond. However, the issue of how fast the Chinese economy can continue expanding is the topic of ongoing debate. Goldman Sachs research team has projected that China may become the world's largest economy by 2041(Goldman Sachs, 2003), which requires that growth does not drop below 8% per annum, provided the right policies are pursued. In PPP terms, of course, China will overtake the US much more quickly over the next decade. Some economists argue

that China can grow even faster, maintaining growth of more than 8% per annum, while others show a profound scepticism about the country's ability to overcome its structural obstacles and avoid severe cyclical downturns. There are already examples in Asia of even the most dynamic and vibrant economies being hit by financial crises, external and internal.

China and India have nearly 40% of the world's population, and now account for almost 20% of global GDP (in PPP terms). As things stand, China and India are likely to become two relevant poles in the economic order which is emerging to replace the bi-polar order represented by the centre – the US – and the periphery. As Figure 3 shows, the size of the economies of China and India is still well below that of the US and Europe. However, once the size of the economy is adjusted to the size of population, both countries occupy a significant place in the world growth league.

Figure 3: World Growth League

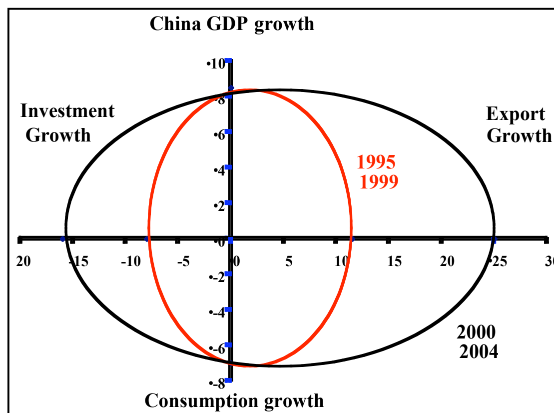


Source: OEF

Drivers of growth

In the last decade China's GDP growth has been driven by strong investment growth and very strong export growth, while consumption growth has remained more subdued (Figure 4). Besides strong and sustained GDP growth rates, China's growth path, which is based on a combination of cheap labour, market size and rapid technological modernization, is redefining the terms of global competition. China is rapidly becoming the world's manufacturing hub, with the fast expansion of manufacturing value-added, in terms of both output and exports. India, on the other hand, has become a major player in global outsourcing and services by capitalizing on its highly educated English-speaking workforce. Both countries are leading changes in world industrial activity, being a source not only of lower-cost sourcing, but of high-value manufactures.

Figure 4: China's growth path



Source: OEF

Expanding investment has been a major and increasingly important driver of China's growth. In the first decade or so of economic reform, investment averaged 36% of GDP. This was relatively high by the standard of developing countries generally, but not in comparison with China's East Asian neighbours where investment shares were at their highest. Since the beginning of the 1990s China's investment rate has grown. In 1993 and again in both 2004 and 2005 investment as a share of GDP exceeded 42%, a level well above the historic experience of China's East Asian neighbours in their high growth periods. In terms of contribution to GDP growth, in 2001-05 increases in capital investment accounted for a little over half of China's economic growth, an unusually high share by international standards (National Bureau of Statistics of China, 2006b:70, Lardy, 2006:2).

Rising investment has been fuelled by an increase in the national saving rate, which reached an unprecedented 50% of GDP in 2005 (Lardy, 2006:2). This mirrors household consumption's modest contribution to growth. Indeed, after having been rapid in absolute terms throughout the reform period, over the last decade consumption growth has become less strong than investment as a source of economic growth. In the 1980s household consumption averaged slightly more than half of GDP. This share fell to an average of 46% in the 1990s. After 2000 household consumption as a share of GDP fell sharply and by 2005 accounted for only 38% of GDP, the lowest share of any major economy in the world. This compares with 70% in the US, 60% in the UK and 61% in India (Lardy, 2006:2).

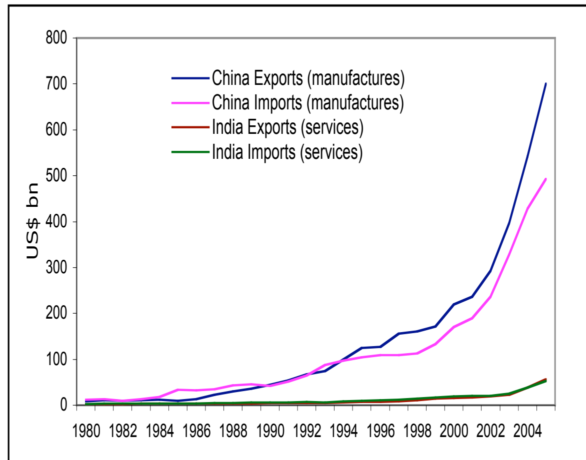
Risks and points of pressure

Trade is everybody's concern

It has been said that the economic rise of China and India represents the most important difference between globalization at the end of last century and globalization in the first quarter of the 21st century. Integration into the global economy, competitiveness and the likely changes to trading patterns and major trading patterns are behind the outstanding performance of these two countries. There are, however, significant differences. India's

integration in the international trade has been smooth and rather gradual, even in the commercial services sector where the country enjoys a competitive advantage. China's share of the international trade, on the other hand, has been growing at very strong rate since the late 1980s (Figure 5).

Figure 5: China and India trade with the rest of the world



Source: WTO, International Trade Statistics database

In the decade from 1993 to 2003, in particular, China's share in the world trade more than doubled from 2.2% to 5.2%, or about US$500bn. Similarly, trade as a percentage of GDP more than doubled between 1999 and 2003, while it contracted in Mexico, Korea, Malaysia and Taiwan. As a result, today China is the third largest exporter in the world, behind the US and the EU (Table 2).

Table 2: Trade rankings, good and services, 2005, US$bn

	Exports of goods	Ranking	Exports of services	Ranking
EU25*	*1328*	*1*	*480*	*1*
US	*904*	*2*	*354*	*2*
China	*762*	*3*	*74*	*4*
Japan	*595*	*4*	*108*	*3*
Korea	*284*	*7*	*44*	*10*
Taiwan	*198*	*11*	*26*	*13*
India	*95*	*20*	*56*	*6*

**excludes intra-EU trade*

Source: WTO

The EU and the US are China's and India's main markets although their share of both markets is significantly different. China has just over 12% of the EU25 total imports – with a gain of about 5% between 2000 and 2004 – and just above 13% of the US total imports – again with more than 5% gain between 2000 and 2004. India has about 2% of the EU25 import market and 1% of the US one. Between 2000 and 2005 trade between China and EU25 doubled, widening Europe's trade deficit. Trade between the European Union and India also accelerated even if at a slower rate (Table 3).

Table 3: Trade flows between EU25-China and EU25-India, US$bn

	2000	2005
EU25 exports to China	*25.7*	*51.8*
EU25 imports from China	*74.3*	*157.9*
Trade balance	*-48.6*	*-106.1*
EU25 exports to India	*13.6*	*21.1*
EU25 imports from India	*12.8*	*18.9*
Trade balance	*0.8*	*2.2*
EU25 total exports	*857.8*	*1070.8*
EU25 total imports	*995.9*	*1176.5*
Trade balance	*-138.1*	*-105.7*

Source: Eurostat

The emergence of China and India is a source of concern, even in developed economies such as the US and the EU. This is particularly relevant for China, which has been seeing its share of global trade growing strongly. The controversial removal of textile quotas, which generated an unnecessary fuss in Europe in the summer of 2005, boosted Chinese exports to the EU by nearly 40% in the first five months of 2005, with exports in the liberalized categories up by 80% over the same period. China now accounts for about 25% of EU textile imports, compared with 17% before the removal of quotas. As a result of its massive exports, China now dominates some sectors such as textile and clothing – but this implies that such exports cannot grow faster than total global demand. However, the European Commission complains that EU exports to China still face a number of tariff and non-tariff barriers to trade and restrictions on investment in manufacturing and in services. There is a growing perception in Europe that incomplete implementation of WTO obligations and barriers to market access are preventing a genuinely reciprocal trading relationship between Europe and China. For instance, in the course of WTO accession China's tariffs were reduced to an average 8.8% for non-agricultural products, but a number of tariff peaks were maintained in some industries, such as textile and clothing, leather and fur, footwear,

ceramics, steel and vehicles, that are important for some EU members states (Commission of the European Communities, 2006).

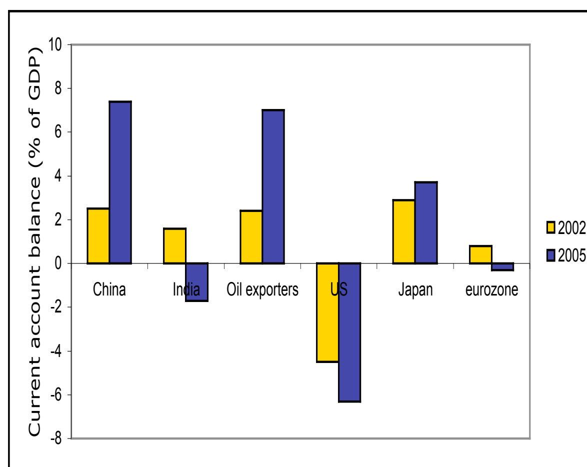
Trade, however, is not a zero-sum game. Asian exporters and raw material suppliers have gained most from China's rising imports even if most of China's gains in North American and European markets have been at the expense of exporters from the rest of Asia. Figures show that Asia's share of world trade, which is about 30%, has hardly changed over the last 15-20 years. Similarly, Asia's share in US and EU imports has hardly changed – and in the US it even fell slightly, under 40%, after the Asia crisis, because of lower prices. China's trade surplus with the US and the EU has widened. Over the period January to August 2006 its surplus with the EU grew strongly, from €65bn to €78bn.

The EU has done better than the US in exporting to China, with its share of the Chinese market growing from 7.5% to 11.2% between 2000 and 2005. As a result of the expansion of China, the US has lost share in the EU market – from about 25% in 2000 to 20% in 2005. Developing countries, including the OPEC, particularly benefit from China's trade pattern.

From trade to FX reserves

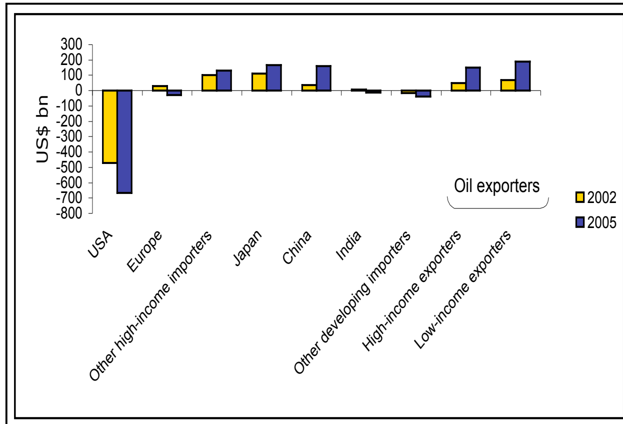
China's strong exports growth has substantially widened the trade surplus. Over 2005 it soared from some US$70bn to over US$100bn. Thanks to high oil prices, oil exporting countries have also seen a substantial growth in their trade surplus. For instance, in 2005 Saudi Arabia and Russia had a trade surplus of about US$91bn and US$118bn respectively. As a result, in 2005 China and oil exporters had a current account surplus of about 7% of GDP – a large increase from 2002 (Figure 6). This compares with the US's deficit of more than 6% of GDP, or US$791bn (Figure 7). On the other hand, India's current account balance deteriorated between 2002 and 2005, from a surplus of 1.6% of GDP in 2002 to a deficit of 1.7% of GDP in 2005. This was due to a significant deterioration in the balance of visible trade – from a deficit of US$9.5bn in 2002 to one of almost US$12bn in 2005.

Figure 6: Current account balance as % of GDP, 2002 and 2005



Source: OEF database

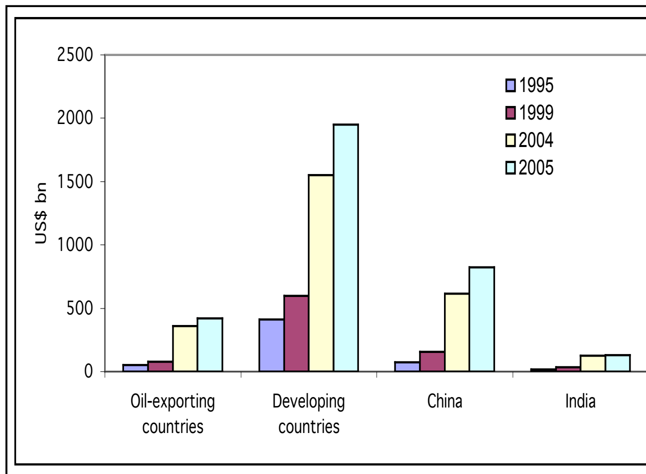
Figure 7: Current account balance, 2002 and 2005, US$bn



Source: World Bank, 2006b

Over the last few years there have been commensurately large build-ups of capital flows and forex reserves to match the trade surpluses (Figure 8). This suggests that the global economy and world financial system are becoming increasingly vulnerable to any swing in the policies of countries with trade surplus. It is also notable that for China and many of the oil economies, exchange rate management has been largely geared to maintaining dollar pegs, which has undoubtedly influenced both trade and capital flows. However, this policy may already be changing, with uncertain consequences for global capital flows as well as trade.

Figure 8: Foreign exchange reserves by region, 1995-2005, US$bn



Source: World Bank, 2006b; OEF database

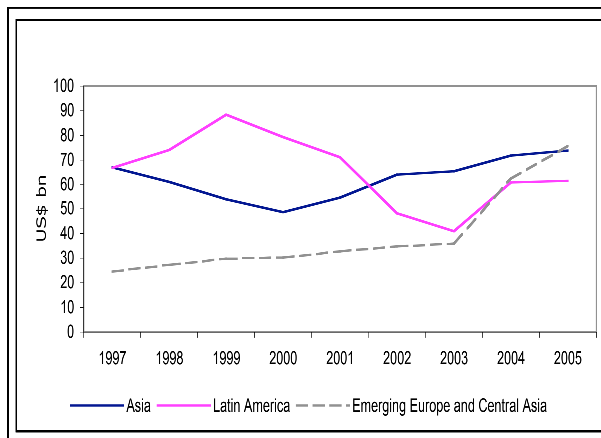
This relatively new role for China – and oil exporters – in terms of global capital flows presents a strategic challenge to these countries as well as to Europe and the US. The continuation of large trade surpluses is not necessarily in the interests of the surplus countries anymore than it is in the interests of the US to accumulate large trade deficits. For emerging market economies, the need is to generate domestic development and jobs, not an excessive external asset base. What China and the oil economies both need in the long run are financial sector reforms that encourage stronger domestic demand growth, reducing their

large trade surpluses. The excess of precautionary saving in China is certainly an issue that the government has been trying to tackle in a number of ways, including now the implementation of enhanced social policies. The key challenges include developing institutions that would enhance the signalling role of financial markets and strengthen financial market discipline as well enabling these countries to benefit fully from increased integration of financial markets. It is equally important for these countries to identify feasible exchange rate regimes, appropriate policies and the knock-on implications of these policies for Europe, the United States and Japan.

Capital flows: the big issues are yet to come

The accumulation of foreign exchange reserves is only part of the story, even if it is the one that has been, and still is, in the headlines. Since 2000 Asia has been playing a very significant role in FDI inflows while other regions have seen a decrease in FDI inflows (Figure 9), although sometimes for reasons not strictly correlated to the emergence of developing Asia.

Figure 9: FDI inflows by region, 1997-2005, US$bn



Source: World Bank, 2006b; OEF database

Again, the steady and rapid increase in FDI inflows to Asia is mainly due to the emergence of China as investors' preferred destination. Between 2002 and 2005 FDI inflows to China rose from US$49.3bn to US$54.1bn (Table 4). In 2005 China's share of total FDI inflows was 30%. Countries of Eastern Europe and Eastern Asia that benefited from trade liberalization and FDI in the 1990s have been seeing a significant number of investors moving to China. In the early 1990s, the Southeast Asian countries received 61% of FDI flows to Asia while only 18% went to China. The situation has now completely reversed. Even a country as remote as Mexico feels the brunt of China's competition.

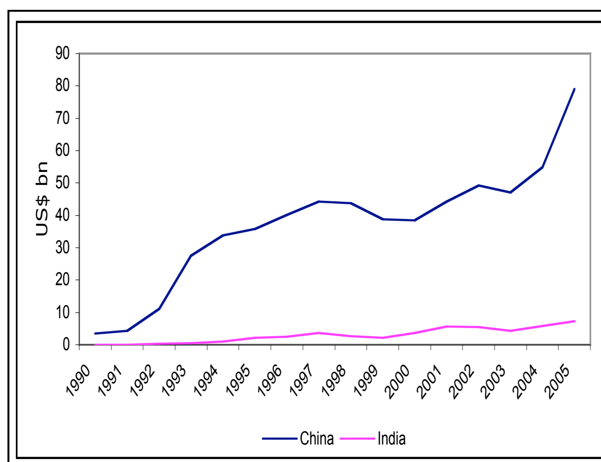
Table 4: FDI inflows to the emergers, 2002-2005, US$bn

	2002	2003	2004	2005
China	*49.3*	*47.1*	*54.9*	*54.1*
India	*5.6*	*4.3*	*5.5*	*6.6*
Korea	*2.4*	*3.5*	*9.2*	*4.3*
Taiwan	*1.4*	*0.5*	*1.9*	*1.6*
Brazil	*16.6*	*10.1*	*18.2*	*15.2*
Russia	*3.5*	*8.0*	*12.8*	*14.6*
South Africa	*0.7*	*0.8*	*0.7*	*6.4*
Total	*124.3*	*107.7*	*165.0*	*179.0*

Source: OEF

India has also seen an increase in the FDI inflows between 2002 and 2005, but remains considerably behind China, with the size of FDI inflows closer to those of Korea. Looking at the trend over the last 15 years (Figure 10), it is clear that FDI inflows have been playing a key role in China's economic development. At the same time, China's growth model, with exports as the main driver, has been, and remains, particularly attractive to foreign investors, who have been pouring money into the country despite problems of corporate governance, political interference and corruption.

Figure 10: China and India: net inward FDI, 1990-2005, US$bn



Source: OEF database

A recent development is FDI from developing countries to other developing countries. China and India have been equally active in investing in other countries in Asia even if Thailand has so far played a much bigger role (Table 5). Indeed the targets of China's capital outflows have been mostly aid and development projects and resource linked enterprises funded by official flows, with China notably competing with Taiwan for a prime role in

regions like Africa. There has been some M&A activity, such as the IBM deal, although the latter has clearly created some concerns over reactions to China's entry into foreign markets and the potential success of such deals once they are completed. Nevertheless, with India, Russia and Brazil obviously active in global M&A, we must expect more deals, possibly quite spectacularly large ones, to materialise from China. Chinese businesses have developed significant links within the rest of Asia, Central Asia and the Middle East, for example, and given the potential scale of China's capital outflow, major projects and/or M&A deals could be on the cards.

Table 5: South-South FDI by multinationals from selected countries

Share of total investment occurring within region	
	South-South
China	*20.7*
India	*25.4*
Thailand	*58.8*
Turkey	*32.0*
Russia	*37.0*

Source: World Bank 2006b

There are deposits of some US$4 trillion – almost double China's GDP – bottled up in China's banks. The central bank is holding FX reserves of US$1 trillion, more than China needs or wants. If trade keeps hitting a monthly surplus of US$20-25 billion, with FDI inflows also contributing another US$5billion or so per month, then the capital outflow China needs to generate just to neutralise this trade and FDI inflow into the balance of payments will be around US$25-30 billion per month. For example, this sum could buy China several large US or EU companies next year as well as funding projects such as several new power stations per month in Africa. With many billions of dollars at China's disposal, this is an important political and economic power base.

Is this going to be a source of geopolitical tensions? Chinese investments in Africa are surely controversial. For instance, in 2000 the Chinese oil company CNPC was considering its listing in the United States, but negative publicity for its involvement in Sudan led the company to create a subsidiary, PetroChina, that could be listed in the United States. Similarly, in places like the Niger Delta Chinese investment in the oil sector has been opposed by some local groups owing to concerns over their impact on labour standards and the environment. Human right organizations are concerned that some of Africa's most authoritarian governments may use the Chinese example and help to ignore international and domestic pressures for democratization. On the other hand Chinese, and Indian, influence in some parts of the world could be turned to everybody's benefit. For instance, as Sudan is the largest source of foreign oil production for China's national oil companies[2], the Chinese

[2] In 2005 Sudan was China's seventh largest supplier of crude oil (Downs, 2006).

could use their influence with the Sudanese government to help bring about a peaceful settlement for Darfur (Wild and Mepham, 2006).

Table 6: Selected Chinese and Indian multinationals in the oil and gas sector, 2004

Company	Ownership	Total assets (US$bn)	Area of activity
CNPC (China)	*state*	*110.6*	*Canada, Ecuador, Kazakhstan, Sudan, Venezuela*
Indian Oil Corp (India)	*state*	*10.9*	*Iran, Libya*
Petro China (China)	*state*	*58.8*	*Nigeria, Sudan, Venezuela*

Source: World Bank 2006b

The quest for energy

Over the next few decades, worldwide demand for energy is projected to grow significantly, driven by population growth, economic development and the expansion of energy-intensive economic activities, particularly in the large developing countries (IEA, 2006). Most projections speculate that energy consumption is likely to grow on the back of robust global economic growth, to which China and India are expected to contribute substantially.[3]

Fossil fuels, such as oil, gas and coal, have delivered most of the world's energy needs in the past, but their use contributes to global warming and other environmental problems. The price of oil has spiked considerably since 2003. High oil prices expose major importers, including most of the world's biggest economies, to significant geopolitical and economic vulnerabilities. As a consequence, significant investments are currently being made in clean and renewable energies. Even if the amount of renewable energy consumed is likely to climb rapidly, most projections have indicated that this will not significantly alter the share of the different types of energy used in the world (Shell, 2005). Several estimates suggest that there may be surprisingly little change in major global sources of energy between 2000 and 2020.

Despite the general push for energy efficiency, strong growth in developing countries such as China and India is likely to result in energy demand growth of about 2.3% per annum (Shell, 2005). According to the National Development Reform Commission, in 2003 China accounted for a significant proportion of world consumption: 7% of crude oil, 25% of aluminum, 27% of steel products, 30% of iron ore, 31% of coal and 40% of the global consumption of cement. Such developments have already significantly recoupled GDP growth and energy consumption at the international level.

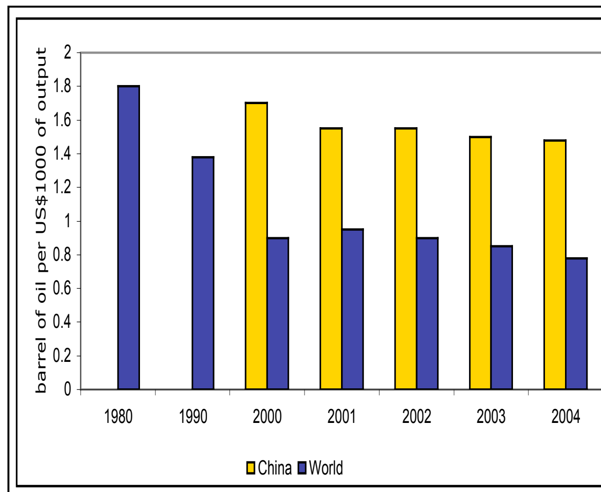
The IEA forecasts that it will be sufficient for China's energy consumption to rise 2.2% p.a. in 2002-2030 to sustain a GDP growth rate of 5% p.a. during this period. Oil demand growth would be considerably more rapid at 3.7% p.a., however. According to OEF estimates, by 2015 Chinese demand for oil will be about 12% of total production – up from 5.0% in 1996. The IEA expects the fastest increase for gas, demand for which would rise by

[3] The rate of growth of energy consumption is, however, difficult to forecast.

4.6% p.a. The IEA projections imply therefore that China's demand elasticity with respect to income is falling below the world average. As a result, the energy intensity of the Chinese economy will decline and gradually approach that of the world economy.

China's energy efficiency has remained substantially lower than the world average. Whereas the Chinese economy requires almost 1.5 barrels of oil to produce US$1000 of output, the global economy needs only half that amount. This is of critical importance because, having doubled its oil demand over the last 10 years to 6.4 million bbl/d, of which around 3 million bbl/d is now imported, China is now the world's second largest oil consumer. Even more strikingly, China accounted for no less than 40% of the new demand for oil in the 2001-2004 period. This rapid growth will continue: 'depending on how demand for energy services is met, China could quadruple its domestic product between 1998 and 2020 with energy use rising by 70-130%' (Shell 2005:192). By contrast the OECD's share of global oil demand dropped from around 75% in the mid-1960s to slightly more than 60% in the early years of the current decade.

Figure 11: Oil intensity, China and the world



Source: Shell, 2005

Adjustments in China's – and presumably India's – energy market are likely to occur at a slow pace. Following the IEA forecast, Shell expects that the energy intensity of total Chinese economic output would still be around 1 barrel of oil equivalent for each US$1000 of output, 50% more than the world average by the middle of the next decade (Shell 2005:192). This means that over the next few years imports will soar, putting pressure on the balance of payments. More importantly, tensions in global energy markets will not decrease. They may even intensify if Chinese growth is stronger than the projected 5%, or if energy-efficiency policies face difficulties when implemented at the local level. Energy efficiency is also likely to remain low in small production units and in state-owned companies. Both the Chinese and Indian governments are likely to address the growing demand for energy through a combination of state control, stringent regulation and reliance on market forces. Given the current trend in Chinese and Indian FDI outflows, a possible scenario is that Chinese and Indian national oil companies try to secure energy supply through long-term

agreements with producing countries; aid and trade instruments are mobilized while return on investment is a secondary consideration (Shell 2005:203).

Is the emergence of India and China changing the global economic order and the global balance of power?

There may be concern about the implied and rapid build-up of power that China, more than India, could see coming from this outflow of capital and, more generally, from its emergence as one of the world's largest economies. Even if, in today's modern global economy, nation-states lack the means to accumulate and deploy economic power in pursuit of policy objectives, it is certainly true that power is derived from economic influence as well as from 'softer' sources such as moral authority, ideas, values and culture, rather than just from military strength (Table 7). Greater economic means also enable the development of traditional forms of deployable power. The United States is currently clearly dominant by economic and military measures, but in the realm of soft power its position has deteriorated sharply since the military intervention in Iraq. In addition, as Table 7 shows, new poles are emerging with potentially enough economic power to increase their military capability.

Table 7: Military power and economic power

	Estimated military expenditure 2004, US$bn	% of global GDP 2004
China	*35*	*4.0*
India	*15*	*1.7*
Indonesia	*4*	*0.6*
Japan	*42*	*11.3*
Pakistan	*4*	*0.2*
Russia	*19*	*1.2*
Turkey	*10*	*0.7*
United Kingdom	*47*	*5.2*
United States	*455*	*28.5*

Source: World Bank 2006c

The global balance of power reflects the sources, distribution, and uses of power among nation-states. The years since the end of the Cold War have brought a rapid shift in the global balance of power, as well as the emergence of new threats. Today many commentators argue that we live in a hegemonic era, with the United States at the centre of the G7 hegemon. However, the rise of new centres of power – economic and perhaps military – means that it is uncertain what the distribution and uses of power will look like in

the next few decades. The evolution may be a significant source of stability and prosperity or a cause of rising hostility.

Changes in the global economic order to accommodate the rise of China are not without their strains. However, while changes in the military and economic order may evolve relatively slowly, the priorities of those in power may change much more rapidly. Tensions mainly emerge from an unbalanced distribution of financial power and resources. Will nations that have significant power use it to drive a shared global agenda, or will competition for resources become a source of global instability? How will nations use their power in their regions, and will those uses result in a more regionalized or more globalized world? Will these nations be increasingly at odds with the broader US-led system of strategic alliances as the emerging poles feel that such a system no longer serves their economic interests or their political ones? As competition for resources is due to grow dramatically on the back of demand from emerging economies, shifts in strategic alliances and the consequent geopolitical instability are likely to increase the risk of conflicts, especially at the regional level. Key economic issues are closely linked to key foreign policy concerns.

How China uses this new global power is really the key issue. Its global ambitions are not a secret, but its strategy is currently based on the idea that there is now a unique 'strategic opportunity' (Shell, 2005). This has been facilitated by globalization trends and by a fundamental cooperative international relations framework that will give the government scope for pursuing its primary policy goal of economic development – the achievement of which is necessary in order to sustain social stability and Communist Party control. A good relationship with the United States is seen as crucial, and this means playing by the rules, at least in the medium term. Nonetheless, the suspicion that America is attempting to contain China provides Beijing with incentives to seek out new partners. China's diplomacy is directed toward expanding Beijing's international influence and playing the role of regional power in Asia.

The transatlantic divisions over the military intervention in Iraq have brought China closer to Europe, even if China's political system makes a true convergence in strategic outlook between the two regions difficult. Similarly the failure of the Doha round of trade negotiations could help China to play a more significant role in East Asia, especially in leading towards the creation of an East Asia Free Trade Area.[4] Another possible development could be the enlargement of ASEAN to include China, Japan and India. Both moves would raise concerns in the United States that some Asian countries could be 'drawing a line down the middle of the Pacific' (Shell, 2005).

Similarly China's initiatives in Africa, most recently the China-Africa Summit held in Beijing in November 2006, leave little doubt about China's ambition of playing an independent role[5] on the international stage. The rise of China also provides Africa with a new set of external relationships, potentially breaking the close link with western governments and creating a

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[4] Unless China decides to ditch multilateralism and pursue a policy of 'spaghetti bowl' FTAs in the region.

[5] By 'independent role' I mean independent from the influence of the US.

new triangular dynamic, in which Africans may benefit from increased competition for trade, investment and even aid (Green, 2006).

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