



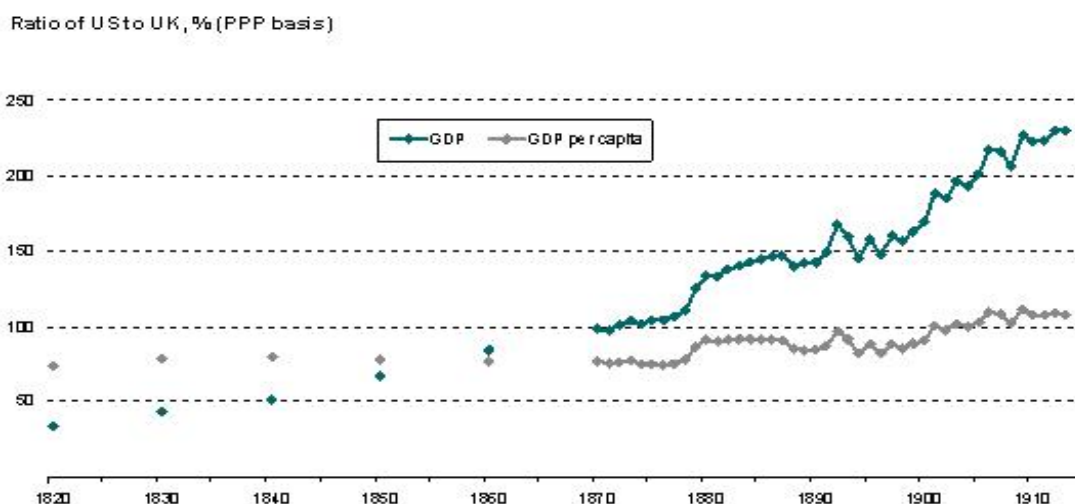
Different paths to economic primacy

China's current challenge for economic leadership differs in some interesting ways from previous examples of catching up and overtaking.

One consequence of both the *Great Convergence* and the *Return of Geo-economics* has been renewed interest in the question of economic primacy: that is, which country will be the world's leading – usually in the sense of largest – economy.¹ The reason for this is obvious. For the first time in a while, the US again has an apparently credible challenger – China – for the number one spot.

One manifestation of this interest is a fascination with the likely timing of when the big emerging market economies will overtake their G7 counterparts in terms of absolute economic size. So, for example, when this year saw Chinese GDP (measured in US dollar terms) surpass Japanese GDP, there was great deal of interest.² More generally, considerable amounts of time have been devoted to projections as to when (or if) China might go on to surpass the US to become the world's largest economy.³

Example 1: US-Britain: 1820-1914



Source: Data from Angus Maddison, available at <http://www.ggd.net/maddison>

Past examples of economic catch-up, convergence and overtaking shed some interesting light on current circumstances. Arguably the classic case is that of the US and Britain in the nineteenth and early twentieth centuries, which marks the last time the world experienced a change in economic primacy. The above chart plots the ratios of US to British GDP and GDP per capita over time, with GDP measured on a purchasing power parity (PPP) basis.⁴ Using both ratios captures shifts in absolute

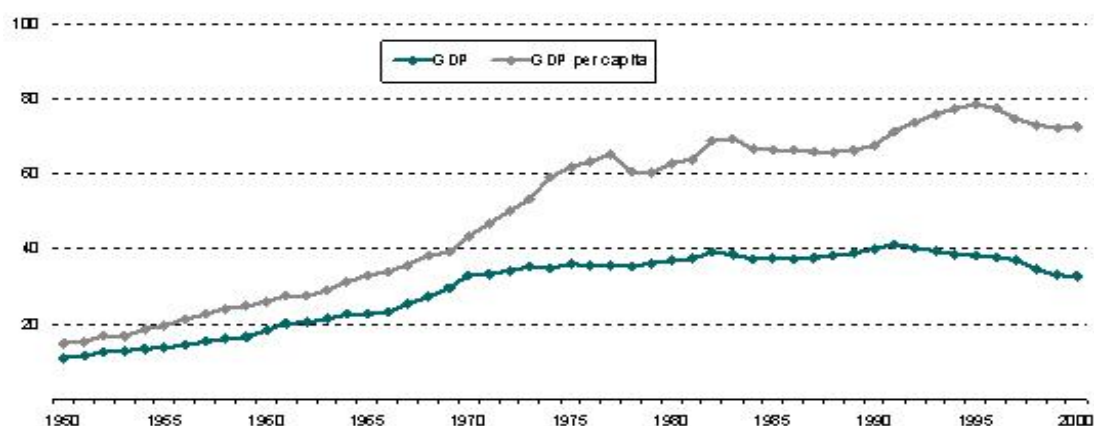


economic size and in economic wealth, and the chart confirms that the US economy surpassed the British one not only in terms of overall GDP, but also in terms of GDP per capita. The shift in primacy was a comprehensive one.

Although there hasn't been a successful overtaking since then, a look at some of the twentieth-century challengers to the US still reveals some interesting features. As recently as the 1980s and early 1990s, Japan was seen as a credible candidate for economic primacy, for example. Yet as the chart below shows, Japan's challenge was mainly a story of convergence (but not overtaking) in GDP per capita. In absolute size, the competition was never really that close.

Example 2: Japan-US: 1950-2000

Ratio of Japan to US, % (PPP basis)



Source: Data from Angus Maddison, available at <http://www.ggdc.net/maddison>

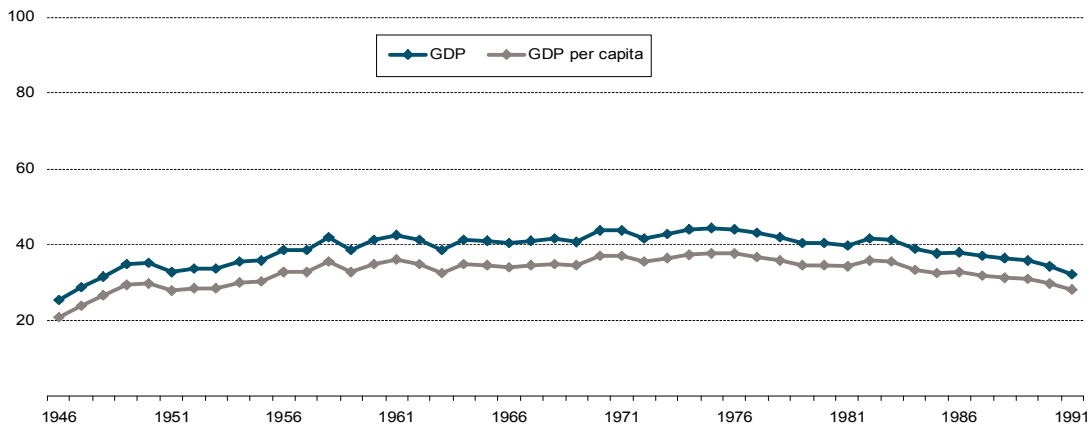
A plot of the ratio of German GDP and GDP per capita relative to that of the US would show a similar pattern. Despite much focus on both economies' post-war economic success, neither mounted a sustained challenge to US economic primacy.

The previous century also threw up a different kind of challenger, in the shape of the USSR. Unlike Japan and Germany then, and China today, the Soviet Union did not seek to compete on the same economic playing field as the US. Indeed, a big part of its very *raison d'être* was the promotion of a quite different economic system. That alternative system failed, however, and while the Soviet Union might have mounted a significant military and strategic challenge, its economic challenge turned out to be much less impressive. After a brief period of catch-up growth following the end of the Second World War, the USSR proved unable to deliver significant convergence in terms of either absolute GDP or GDP per capita:



Example 3: USSR-US: 1946-1991

Ratio of USSR to US, % (PPP basis)

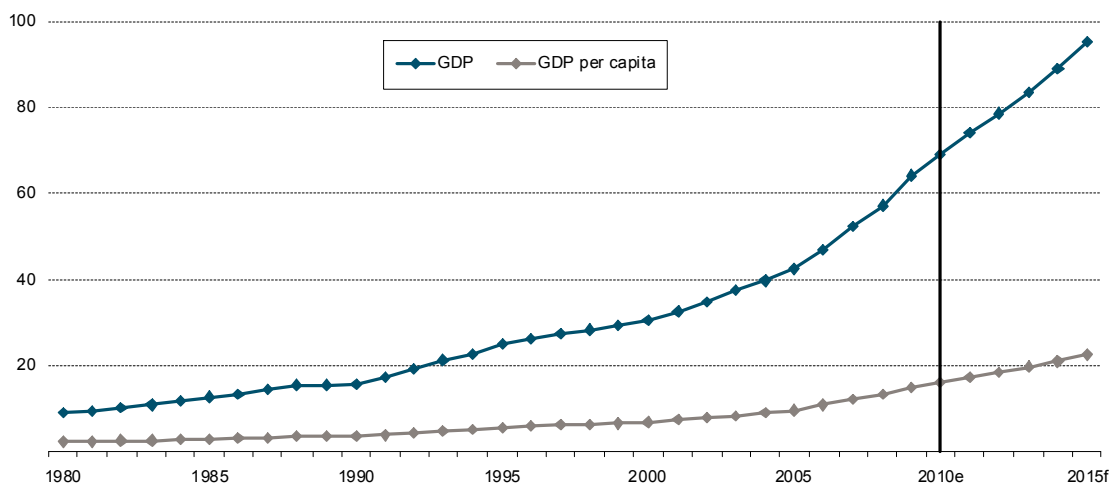


Source: Data from Angus Maddison, available at <http://www.ggd.net/maddison>

So, how does China's current challenge for economic primacy compare to these earlier examples?⁵

Example 4: China-US: 1980-2015F

Ratio of China to US, % (PPP basis)



Source: Data from IMF World Economic Outlook database, October 2010

As the final chart shows, the Chinese story is overwhelmingly one of catch-up in terms of the absolute size of GDP. Granted, there is also some modest but still



significant convergence in GDP per capita. But it is mainly this limited convergence in wealth multiplied by China's vast population that is powering China's drive to primacy.

As a result, if and when China does overtake the US to become the world's largest economy, a large wealth gap will remain relative to the US. This feature differs from those earlier examples of successful and failed challenges for primacy, where either the measures of primacy moved reasonably closely together, or where the action was mainly in per capita terms. We have grown used to thinking of the various manifestations of economic primacy – absolute GDP size, GDP per head, and also factors such as technological leadership – as being quite closely correlated. That assumption no longer holds in the way it used to.

Does this matter? It might matter quite a lot. Moving from a global economy where the world's largest economies were also among its wealthiest to one where the largest economies might have only middle-income status is likely to have interesting implications for how the world economy works in general. One area where this is particularly likely to be the case is global governance – the subject of a future IEC.

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¹ On the Great Convergence, see IEC#4. On the Return of Geo-economics, see Mark Thirlwell, *The return of geo-economics: Globalisation and national security*. Lowy Institute Perspectives. Sydney, Lowy Institute for International Policy, September, 2010.

² For example Jamil Anderlini, China's jump signals shift in global power. *Financial Times*, 16 August 2010.

³ Perhaps the most famous of these are the BRICs forecasts produced by economists at Goldman Sachs. For a recent example see Jim O'Neill and Anna Stupnytska, *The long-term outlook for the BRICs and N-11 Post Crisis*. Goldman Sachs Global Economics Paper No. 192, December, 2009.

⁴ For a good explanation of why GDP measured on a PPP basis rather a market exchange rate basis is the appropriate metric, see Ian Castles and David Henderson, International comparisons of GDP: issues of theory and practice. *World Economics* 6 (1) 2005.

⁵ The previous comparisons used data based on Angus Maddison's GDP set. This final chart uses estimates taken from the IMF's World Economic Outlook database. There are big differences between the two when it comes to the estimated size of China's GDP at PPP. Maddison would have the ratio of Chinese to US GDP as much higher than the IMF. In 2008, the last year of the Maddison data, his ratio of Chinese to US GDP is almost 94%. In contrast, on the IMF numbers the ratio is only 57%. The discrepancy reflects the IMF's updating its estimates based on the 2005 International Price Comparison Program (ICP). Maddison rejected the results of the 2005 ICP exercise for China. For Maddison's take see Angus Maddison and Harry X. Wu, Measuring China's economic performance. *World Economics* 9 (2) 2008. For a defence of the ICP estimates, see Yuri Dikhanov and Eric V. Swanson, Comment: Maddison and Wu: 'Measuring China's economic performance'. *World Economics* 11 (1) 2010.