

# The emergence of the new economic order: Growth in the G7 and the G20<sup>☆</sup>

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## Abstract

The massive reconfiguration of the world economy over the next decade will lead to a New Economic Order by 2020. China will displace the U.S. as the world's leading economy and India will overtake Japan. This will shift the balance of the G20 from the leading industrialized economies of the G7 to the emerging economies, especially China and India. The rise of the Asian model of economic growth will underscore the importance of globalization and will shift the balance of the theory of economic growth from innovation to investment in human and nonhuman capital. The transformation of official statistical systems to reflect these changes is already underway around the world.

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## 1. Introduction

Recovery from the Great Recession of 2007–2009 by the U.S., Japan, Canada and the four European economies of the G7 has been slow and fitful. The most important impact of the recession on the emerging economies of the G20 was the collapse of global trade in late 2008 and 2009, but

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this was quickly reversed. These economies have continued to grow much more rapidly than the world economy as a whole. While fiscal consolidations have become more pressing in the G7, both economically and politically, the international imbalances in the emerging economies of the G20 have been substantially reduced.

An obvious threat to the restoration of economic growth in the G7 is the financial and fiscal debt crisis in Europe and the inability of international institutions to cope with a financial crisis in large countries like Spain and Italy. Among the emerging economies of the G20 the challenges are different but equally daunting. Can China successfully cope with inflationary pressures following the vast expansion of lending in response to the financial crisis without a substantial slowdown? Will India be able to undertake a fiscal consolidation and deal with a more rapid inflation rate?

In this paper we shift attention from short-term threats to the world economy, as formidable as these may be, to growth potential over the next decade. The fundamentals of the world economy are strong. Moreover, it is time to recognize the trends that have developed since the watershed reforms of China and India more than two decades ago. Our theme will be that a massive reconfiguration of the world economy is gradually unfolding and will be completed in the next ten years. This will shift the balance within the G20 away from the industrialized economies of the G7 and toward emerging economies, especially China and India, creating a New Economic Order.

The first major trend is that *during the next decade, 2010–2020, world economic growth will accelerate, relative to the past two decades, 1990–2010*. The recovery of the U.S. has recently slowed, but policy-makers have avoided the much-discussed “fiscal cliff”. Europe is already in recession and may slow further, but the financial and fiscal crisis seems to be abating. While labor productivity growth in the G7 economies will nearly equal the pace of the past two decades, economic growth in these economies will encounter the formidable headwind of a decline of the labor force in Japan and much of Europe.

During 2010–2020 Chinese growth will slow relative to the rapid rate of the past two decades. However, growth in India will slightly accelerate and both economies will continue to grow much more rapidly than the world economy. As these economies increase in relative importance, the growth rate of the world economy will rise substantially, relative to the growth rate of 1990–2010. Overall, the growth rates of the G20 economies will be almost equal to that of the world economy, so that the decade of 2010–2020 will begin and end with the G20 accounting for about eighty percent of world GDP.

The second of the major trends in the world economy over the next decade is that *China will overtake the U.S. and India will overtake Japan*. One of the most heralded economic developments of 2010 was that China overtook Japan as the world’s second largest economy. In terms of *purchasing power parities* this was no longer news. According to the World Bank’s scorecard, China overtook Japan more than five years earlier (World Bank, 2008). In 2010 China overtook Japan in terms of *exchange rates* rather than purchasing power parities. In 2012 India overtook Japan in terms of purchasing power parity and will continue to grow much more rapidly.

According to the authoritative estimates of the late Angus Maddison (August Maddison, 2001) the U.S. has been the world’s No. 1 economy for more than a century. However, China is growing much more rapidly than the U.S. and will continue to do so. When will China become No. 1? The International Monetary Fund’s *World Economic Outlook* for October 2012 calls for parity between the two economies in 2017 in terms of purchasing power and our projections agree (International Monetary Fund, 2012). However, the U.S. and China made up more than a third of the world economy in 2010 and this proportion will increase by 2020, consolidating the rise of the G2, China and the U.S., as the world’s leading economies.

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