



Welcome to the twenty-first century

In 2001, two momentous events shook the world. On September 11 a small group of bold terrorists mounted a series of daring attacks on the United States, and on September 17 the World Trade Organization concluded its 15-year-old membership negotiations with China. Although the world's preeminent geopolitical power had been the target of other terrorist attacks during the preceding decade, 9/11 was qualitatively different not only because of the large number of victims but also because it undermined the country's sense of security. Likewise, China's economic and financial rise had been in the making since the 1980s, but it was not until the early 2000s that the world came to the realization that Earth's most populous country would one day also become the largest economy, and that it was already the world's largest exporter and the second largest importer. Chinese exports, trade surpluses, and currency reserves soared, with the US reaching record deficits in its current account. These global imbalances set the stage for the most severe global economic and financial crisis in decades.

Welcome to the twenty-first century. The new centennial is a teenager and it has already developed its own, unique personality. This book deals with the challenges facing us in the new century. It is not one more exercise at projecting past trends into the future, but an analysis of the major global *turning points* confronting us, namely, the game-changing events and trends that are transforming the world beyond recognition. A series of such inflexion points has occurred over the last decade or so – and they will reshape the economic, socio-demographic, political, and geopolitical affairs for decades to come:

- The global economy is out of balance. Most of the large rich economies, with the notable exceptions of Germany and Japan, are running large trade deficits while most emerging economies are enjoying large surpluses. After two decades of intense economic growth, emerging

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economies now represent about half of global economic activity. Emerging economies are also flexing their financial muscle because they own two thirds of foreign exchange reserves, of which they are accumulating an additional billion dollars *every day*.

- Emerging-market multinational firms are expanding around the world like wildfire. Once a marginal phenomenon, as of 2014 they represented 31 percent of the largest 500 companies in the world, 29 percent of the total number of multinational firms, and 28 percent of new foreign direct investment flows over the previous five years.
- Demographic conditions are changing fast. For the first time in human history, Japan and several Western European countries have inverted age pyramids with more people above age 60 than below age 20. Also for the first time, more people live in cities than in the countryside, and greater numbers suffer from obesity or being overweight than from hunger.
- The political landscape in many parts of the world has taken a turn towards uncertainty, chaos, and anarchy. For the first time since World War II there are more countries in the world affected by state failure than countries ruled by dictators. In general, there is a sharp decline in the legitimacy and capacity of the state in both developed and developing countries.
- We live in an increasingly disparate world. Although income inequality *across* countries has decreased since the turn of the twenty-first century due to the rise of the emerging economies, inequality *within* countries has continued to increase, posing difficult social and political problems in developed and developing countries alike.
- Consumer markets are being transformed by the rise of the global middle class, especially in Brazil, Mexico, China, India, and South-East Asia. Demand for consumer durables and non-durables as well as services will expand rapidly as growth in emerging economies continues to lift people out of poverty. At the top of the social pecking order, the high-net-worth elite will continue to expand and to include more women as a proportion of the total.
- Technology, especially of the mobile kind, continues to revolutionize consumption and lifestyles. Manufacturing and distribution are also being transformed with the advent of artificial intelligence, smart robotics, nanotechnologies, 3D printing, and drones. Meanwhile, bio-informatics and biotechnology promise to overhaul healthcare.

- Economic growth is driven not so much by labor and capital but by institutions, the norms and rules of the game that make it possible for entrepreneurs, companies, suppliers, and financiers to interact on a daily basis. Governments compete with each other to create the best institutional conditions to foster entrepreneurship and innovation.
- Sustainability has become a key priority. Top scientists predict that, without corrective action, climate change will become irreversible at some tipping point during the twenty-first century. By 2030 food prices could be twice as high as in 2012, and half of the world's population could be affected by severe water shortages.
- The financial system continues to give headaches to customers and regulators. A decade after the first signs of trouble emerged, banks and other financial companies have adapted only minimally to the new regulatory environment, the need for greater transparency, and disruptive technological trends.
- The global balance of power is shifting rapidly. During most of the twenty-first century India will be the biggest country in terms of population, China the largest in output, and the United States the richest among the major economies on a per capita income basis.

Some people find it hard to accept that the world order they grew up with might be coming to an end. Others feel that change is so pervasive that one can no longer assume any givens. Both reactions are understandable, precisely because the changes are so massive and they affect so many different aspects of global affairs. There are simply too many moving parts. Complexity is a key feature of contemporary global society. Although the risks and the stakes were also high, the Cold War period never gave us a sense of overwhelming insecurity. Even the risk of nuclear war provided the foundation for the doctrine of “mutually assured destruction,” which made it possible for the two global superpowers to find an accommodation. The twenty-first century is different. We are at the mercy of the catastrophic disruptions that a malfunctioning component of the increasingly complex global system can bring about. Think about epidemics such as SARS or the swine flu, global financial meltdowns like the one triggered by the subprime crisis in the United States, the European sovereign debt debacle, the riots generated by rising food prices in much of the developing world, or the quake and tsunami in Japan

and its widespread consequences for global production and trade. The twenty-first century is the century of complexity.

Perhaps we could easily learn to cope with complexity if it did not come hand in hand with uncertainty. We know how to deal with risk: we can measure it, we can prepare for it, we can anticipate the consequences. But uncertainty is a situation in which we do not understand the variables involved and we lack the tools to quantify them. Uncertainty is difficult to grasp or comprehend. The rise of the global network society has unleashed many different kinds of uncertainties. We are just not sure as to what the effects of droughts, declining fertility rates, or political upheavals will be. We simply have little clue. The twenty-first century is the century of complexity coupled with uncertainty.

Another most intractable feature of the twenty-first century is that most changes appear to be paradoxical. Consider the following examples. The rise of the emerging economies is making it possible for hundreds of millions of people to overcome poverty. However, it also poses stern challenges in terms of job losses in the developed world, competition for energy and natural resources, and global economic and financial governance. We will explore this topic in Chapter 2. Another example is the rise of the emerging-market multinationals, companies that were invisible a few years ago but have suddenly become household names. The paradox about them is that their increasing power and competitiveness is not necessarily based on the possession of technology or marketing skills. They have rewritten the rules of business competition, much to their advantage and at the expense of the traditional multinational firms from Europe, the US, and Japan. We will cover the fascinating rise of the emerging-market multinationals in Chapter 3.

Equally puzzling are the demographic changes that are taking place in the world. The decline in the average number of children born to each woman has proceeded much faster in Europe, East Asia (especially China and Japan), and to a lesser extent North America. Women in those regions now have much better economic, political, and social opportunities available to them. But these societies are aging very quickly. In the meantime, population continues to increase in Africa, South Asia, and the Middle East. It is also ironic that as economic development spreads around the world, we find ourselves in a situation in which there are more people suffering from obesity (about one billion) than from hunger (800 million).

As of the first decade of the twenty-first century, the world has become predominantly urban, with more people living in cities than in the countryside for the first time in human history. Competition for natural resources now affects not only oil and rare minerals but also food and water. We will address the causes and the consequences of these and other demographic turning points in Chapter 4.

If there is an enigma that is likely to haunt us during the twenty-first century, it is why democracy has made great strides as the dominant form of government in the world while at the same time the number of failed states has proliferated. Nearly 50 countries suffer from some degree of state failure, including not only egregious examples such as Chad, Congo, Sudan, Somalia, Iraq, and Afghanistan, but also other threatened states like Mexico, Nigeria, Pakistan, and India. This trend has caused major problems in the global economy and in trade, and made terrorism the dominant form of violent conflict, whereas in the twentieth century conventional wars were. In Chapter 5 we will explain that the confluence of rapid demographic growth, political instability, and natural resources in Africa, the Middle East, and South Asia poses serious threats to global society in the twenty-first century. Another paradoxical trend is the new emphasis on good institutional governance at the same time that state capacity is diminishing due to the ideology of small government and the fallout from the sovereign debt crisis.

Global inequality and poverty have also come to characterize the twenty-first century in ways that are very different from the recent past. For the first time in two centuries, we are witnessing less inequality *across* countries at the same time that inequality *within* both developed and developing countries is on the increase. Enigmatically, poverty is coming down even in countries in which inequality is on the rise. We will analyze these puzzling turning points in Chapter 6.

While the middle class has contracted in Western Europe and the United States, it is swelling in the emerging world. For the first time in human history, more than half of the world's population will be part of the middle class within a decade. As we will see in Chapter 7, China and India combined will be greater as a middle-class consumer market than Europe and the United States combined. This will enable them to participate in the writing of global market rules, including regulatory matters and product standards. The numbers of high-net-worth individuals are

also growing quickly, especially in emerging economies, with the number of female millionaires growing faster than the number of male millionaires.

A main driver of economic vitality in the contemporary world is technology. Mobile technology is transforming consumption and lifestyles, especially among the young. As analyzed in Chapter 8, manufacturing is undergoing a massive revolution due to the implementation of artificial intelligence, smart robotics, nanotechnologies, and 3D printing. Meanwhile, distribution is also becoming automated, and drones may soon deliver goods to homes and offices. Life, and the way we experience life, are changing fast, and so is healthcare, thanks to advances in genetics, biotechnology, and bioinformatics.

Economies are no longer amalgams of capital and labor. Institutions ranging from the educational system to the legal order, and from the stock market to corporate governance, have become key ingredients for economic success. In Chapter 9 we will assess the renewed emphasis on institutions as the foundation for economic growth, entrepreneurship, and innovation. We will also examine the differences between men and women when it comes to founding and managing ventures.

Growth in the emerging economies has come hand in hand with environmental degradation. In developed and developing countries alike, a quest for sustainability is on. The emphasis is not only on energy, but also on green production and consumption of goods and services. Agriculture, construction, and tourism have also become targets of sustainability efforts. Technology and behavioral change are touted as the solutions. Emerging economies are making contributions of their own to global sustainability, as the cases of sugarcane ethanol in Brazil, water management in Thailand, or wind power in China and India attest. Water and food are also becoming scarce commodities. We will examine the challenge of global sustainability in Chapter 10.

Before taking stock of the global balance of power, we will review in Chapter 11 the trials and tribulations of the financial system, a part of the economy that is as indispensable as it is problematic at the present time. Banks and other financial companies are essential to the economy, but they are having enormous trouble adapting to the post-crisis environment, with increased regulatory scrutiny, societal demands for transparency, and a limited ability to adapt to disruptive technological change.

These economic, demographic, and geopolitical turning points are rapidly eroding the dominance of the United States as the leading global power. In April of 2011 the International Monetary Fund shook American public opinion with its prediction that China's economy would be the world's largest by 2016. We will explore in Chapter 12 to what extent historical patterns in the rise and fall of dominant global powers help understand the new situation created in the twenty-first century, one in which not one but several powers may share the global stage.

Finally, in Chapter 13, we will examine the implications of these global turning points for business and for society at large. We seek to identify the challenges and the opportunities that stem from each of them. We will argue that the world needs new approaches to global governance in order to deal with the complexity, uncertainty, and interconnectedness that characterizes the global economy, the international system of states, social dynamics, and geopolitics in the twenty-first century. The world is replete with uncertainty and complexity, and we do not seem to have in place the economic, political, and geopolitical institutions to cope with it all.

The issues summarized – the large and persistent global financial imbalances, the growing lack of competitiveness of rich-country firms relative to the emerging-market multinationals, population aging, urbanization, the obesity epidemic, failed states, terrorism, the unequal distribution of income, environmental degradation, global warming, the looming crisis over food and water, and the lack of global political leadership – present a formidable set of challenges. The potentially negative impact of these issues is exacerbated by the complex ways in which they interact with one another, the uncertainties they generate at all levels, from the local community to the global system, and the speed at which their effects can be felt in an interconnected world. Welcome to the twenty-first century.



A global economy out of balance

KEY GLOBAL TURNING POINTS

Emerging economies have come to represent more than half of global economic activity. They account for two thirds of foreign exchange reserves and are accumulating an additional billion dollars *every day*.

From an economic point of view, the transition from the twentieth to the twenty-first century took place in the midst of growing trade and financial interrelationships among countries, and the widespread impact of information and telecommunication technologies. Another important development was an increasing cross-national convergence in policymaking, as a result for the most part of a consensus over the fundamental features of monetary and fiscal policy, the benefits of deregulation, and the importance of letting markets allocate capital, labor, and other resources. The global economy was simply tending towards greater integration under a liberal set of rules (Abdelal 2007; Stiglitz 2002). As Robert Gilpin (1987: 389; 2000) once put it, the late twentieth century resulted in an “increasing interdependence of national economies in trade, finance, and macroeconomic policy.” The global economy was moving in the direction of tighter integration in all of its different aspects, from production and distribution to capital and information flows. In this vein, sociologist Manuel Castells (1996: 92) argued that the global economy had become “an economy with the capacity to work as a unit in real time on a planetary scale.”

Policymakers were hoping for equal opportunities for all countries that joined this new phase of globalization. Markets were open to everyone in an apparently inclusive way. The frontier of development and well-being was extended to a greater number of economies, all of which were supposedly converging on the living standards of the most advanced countries. Policymakers and analysts also thought that the global economy was eminently governable, and that business cycles were a thing of the past. The sociologist

Roland Robertson (1992: 8) summarized the new mind-set by arguing that globalization encompassed both “the compression of the world and the intensification of consciousness of the world as a whole.”

As soon as the new century was ushered in, however, a series of crises turned the global economy upside down: the bursting of the technology bubble, a string of high-profile corporate scandals, and, above all, the global economic and financial crisis triggered by the implosion of the American subprime mortgage market. The “great recession” accentuated a trend towards a two-speed global economy. Despite difficulties in some of them, emerging economies weathered the storm much better than both developing and developed markets, surging ahead economically and financially while the richest and the poorest economies languished and wrestled to cope with high private and public indebtedness.

The first decade of the new century was marked by growing imbalances, which continue to threaten global economic and financial stability. Government debt in the high-income countries has reached levels not seen since the end of World War II, during which the allies borrowed heavily to finance the war effort. The emerging economies have expanded their exports of manufactured goods, mostly to Europe and the United States, while commodity exporters have benefited from rising prices, which has resulted in persistently large trade surpluses in some parts of the world and large deficits in others (see the Box). This trend accelerated considerably after 2001 with China’s accession to the World Trade Organization. Lastly, growing trade imbalances have led to a peculiar situation for the first time in global history, namely, the accumulation of large foreign currency reserves in emerging and developing countries, which have become net creditors to the richest countries. Emerging economies have been earning about a billion dollars of additional reserves *every day*, with more than 300 million going to China alone.

Global economic exchange

Countries trade goods, services, and capital with one another. In the process of doing so, some accumulate deficits while others generate surpluses. In the absence of inter-planetary trade, the deficits in some

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countries need to be compensated by surpluses of an equivalent magnitude in other countries.

The broadest measure of the economic transactions of a country with the rest of the world is the current account. It comprises the net balance of trade in goods, trade in services, income generated or paid abroad (e.g., dividends on investments), and transfers, such as workers' remittances or foreign aid.

If the current account is in deficit, the country needs to find financing from abroad either in the form of capital transfers or a foreign loan. Countries with a surplus provide the financing and accumulate reserves to the same extent.

During the first decade of the twenty-first century countries such as the US, the UK, much of Continental Europe, and the oil-importing countries in the developing world ran persistently high deficits in their current account, which means that they imported much more than they exported. By contrast, Germany, Japan, China, and a long list of exporters of oil and other commodities accumulated large surpluses.

The growing trade and financial imbalances in the global economy pose serious threats to stability and governance. It is also important to note that, with only a few exceptions, emerging economies are providing the financing for the large current account and government deficits in the high-income countries.

One should keep in mind, however, that the root causes of these growing imbalances do not lie in the shifting structure of international economic exchange alone. "While currency and trade adjustments have a role to play in reducing the problem of imbalances," Pankaj Ghemawat (2011: 169) has cogently argued, "the United States also needs to address the domestic factors that underlie its savings-investment gap." So does most of Western Europe, with the exceptions of Germany, the Netherlands, Denmark, and Switzerland. At the other end of the spectrum, China should stimulate domestic demand as an engine of growth.