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The Challenge to Europe: Regional Powers and the Shifting of the Global Order

Europe's position as the most important economic area in the world is gradually being challenged by China and other regional powers which have been growing faster than the EU in the last 20 years. An economic and political power shift is taking place. How can Europe best cope with this challenge?

On a world scale, economic integration has risen rapidly in recent years. The Uruguay and Doha Rounds have reduced trade restrictions; transport and communication costs are falling. The world is getting flatter. The former distinction between core and periphery (rich industrialised countries and poor developing countries) is no longer valid because many developing countries are catching up. There is an economic and political power shift, which is associated with a relative decline of the "West" and a relative rise of the "East". The emerging economies are regional powers and partly even global powers. China and other regional powers will not seek to undermine the capitalist system and the ideas and principals of the global liberal order, as some authors have argued, but instead will try to gain more leadership within it.[1] In this paper I will show how the world is being changed by these nations, focusing on China, India, Brazil and South Africa, which use their respective economic, hard, structural and soft powers.[2] We shall also analyse how the EU is affected by these fast and deep political, economic and technological changes, which have led to the rising influence of the regional powers. We shall talk about "regional powers", a term often used by political scientists, rather than using the term "emerging economies".[3] Based on empirical comparisons and regression analyses in two of my former publications,[4] we define a regional power as follows:

A regional power is an economic power (in a given region) that has influence and possesses the capacity for regional and global action. It has a relatively large population and covers a relatively large area. The regional power achieves high economic growth, above the regional average, over a longer period of time and thus provides a growing market for the region. It plays an important role in trade within the region. It develops industrially and technologically; the state expenditures for R&D increase and come close to the level in the OECD world. The regional power has regionally and globally active businesses that are getting stronger and will lead to fierce competition for businesses from the OECD world within the regional–global value chains. The regional power increasingly provides public goods in the form of a stable currency, a reliable monetary policy and develop-

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1 For a discussion on the leadership of regional powers, the changes in the liberal order, the decline of the West and the rise of regional powers, from the "Washington Consensus" to the "Beijing Consensus", and the rise of authoritarianism, see G.J. Ikenberry: The Future of the Liberal World Order. Internationalism After America, in: Foreign Affairs, Vol. 90, No. 3, 2011, pp. 56-68; S. Schirm: Leaders in Need of Followers: Emerging Powers in Global Governance, in: European Journal of International Relations, Vol. 16, No. 2, 2010, pp. 197-222.

2 On economic, hard, structural, soft and smart power see J.S. Nye: The Future of Power, New York 2011, Public Affairs; D. Lemke: Dimensions of Hard Power: Regional Leadership and Material Capabilities, in: D. Flemes (ed.): Regional Leadership in the Global System: Ideas, Interests and Strategies of Regional Powers, Farnham 2010, Ashgate, pp. 31-50; S. Strange: What is Economic Power, and Who Has It?, in: International Journal, Vol. 30, No. 2, 1975, pp. 207-224; D. Flemes (ed.), op. cit.

3 The term "emerging economies" is defined by economic criteria (per capita income, increase of share in world markets of manufactured goods and/or services); see G. Gaulier, F. Lemoine, D. Ünal: EU15 Trade with Emerging Economies and Rentier States: Leveraging Geography, Paris 2009, CEPII Document de Travail 25, p. 12; for the economic debate on "regional powers", "rising powers", "southern engines of global growth" and "emerging powers" see R. Kappel: On the Economics of Regional Powers, in: N. Godehardt, D. Nabers (eds.): Regional Powers and Regional Orders, London 2011, Routledge, pp. 68-92; I. Bensidou, F. Lemoine, D. Ünal: The Integration of China and India into the World Economy: A Comparison, in: The European Journal of Comparative Economics, Vol. 6, No. 1, 2009, pp. 131-155; A.U. Santos-Paulino, G. Wan (eds.): Southern Engines of Growth, Oxford 2010, Oxford University Press. Political scientists have dealt with the concept of regional powers for years, focusing on leadership, hegemony and influence. Nolte's political science approach identifies fundamental political criteria; see D. Nolte: How to Compare Regional Powers: Analytical Concepts and Research Topics, in: Review of International Studies, Vol. 36, 2010, pp. 881-901.

4 R. Kappel: On the Economics of Regional Powers: Comparing China, India, Brazil, and South Africa, Hamburg 2010, GIGA Working Paper No. 145; and R. Kappel: On the Economics of Regional Powers, in: N. Godehardt, D. Navers, op. cit.

ment aid. It takes on a growing role in the governance of the region, particularly with respect to regional cooperation agreements. And it uses its economic and network power to influence development on a global and regional scale.

In the following, this paper will develop a proposal for a concept of the economics of regional powers and summarise the empirical results. It will then illustrate how much the EU is challenged globally and regionally by the regional powers, and how strong the EU is economically. This contribution focuses on trade, direct investment and technological rise. The final section analyses the global and regional significance of China, India, Brazil and South Africa, and their role in international trade and investment.

Empirical Results: How Important Are Regional Powers?

Testing several indicators, we identified the following countries as regional powers: China, India, Brazil, South Africa, Mexico, Indonesia, Egypt, Saudi Arabia and Turkey.[5] Our approach and the empirical observations indicate that other countries are not regional powers because they fail to meet some elements of the aforementioned definition and criteria, i.e. small physical area and small population, low growth, weakly developed industry, slow technological upgrading, low regional trade integration, weak soft power and limited provision of public goods etc. – for example, Israel, Iran, Pakistan, Thailand, Vietnam, Argentina, Venezuela and Nigeria. They are important but do not belong to those nations which exert global and regional influence, either in regional or global institutions or as economic hubs in the region. For comparison, the data of some of the aforementioned countries were taken into consideration.

A review of the literature shows that there are numerous approaches to describing power and leadership in economics.[6] On the basis of these theoretical approaches, we developed criteria regarding the "economics of regional powers". These are: *economic dynamism* (attractiveness to foreign direct investment – FDI); *geography* (positive relations with neighbours leading to cooperation, increase in growth and technological spillover); *vertical networks* (technologically leading businesses from the regional powers determine the governance in these chains, and leadership in the global value chain represents an important basis for the economic position of regional powers in the region); *regional integration* (regional powers take on a key role in regional organisations – for example, in the governance of an anchor currency); and last but not least *relational power* (competitors from many regions are competing with the regional power). We tested for country size, population, per capita income, growth of GDP, foreign trade, industrialisation, direct investment, research and development expenditure, public goods, and institutions. Some of the significant findings of the descriptive statistics are illustrated in the following six observations, thereby focusing our analysis on China, India, Brazil and South Africa.[7]

- *Observation 1*: Regional powers have a very large land area and a large population in comparison to other countries in their region. India and China are the most heavily populated countries in the world. China's share of the global population is approximately 20%; India's is 17%. Brazil and South Africa are smaller in terms of population and area; however, they are relatively large in their respective regions.

- *Observation 2*: Some regional powers have a higher per capita income than the world and regional average. Per capita incomes in India and China, however, are below the regional average, whereas South Africa's is significantly higher. The average growth in income per capita in the regional powers was higher than that of the respective regions in the period 1990–2009, even though some smaller countries in the regions were able to achieve much greater growth (for example, Taiwan, Singapore and Botswana). The average income of regional powers was still only approximately 15% of the income of the rich countries.

- *Observation 3*: With the exceptions of Brazil and South Africa, regional powers have achieved a higher average growth of GDP (1980–2009) and contribute significantly to global and regional growth (see Figure 1). Only China and, to a lesser degree, India are of importance for the global economy; Brazil and South Africa, in contrast, are much less important. Both Brazil's and South Africa's average growth during the last 30 years amounted to only approximately 2%; due to their lower economic dynamism they are not "engines of growth", either globally or regionally, as is often assumed.

5 Russia is excluded from our analysis.

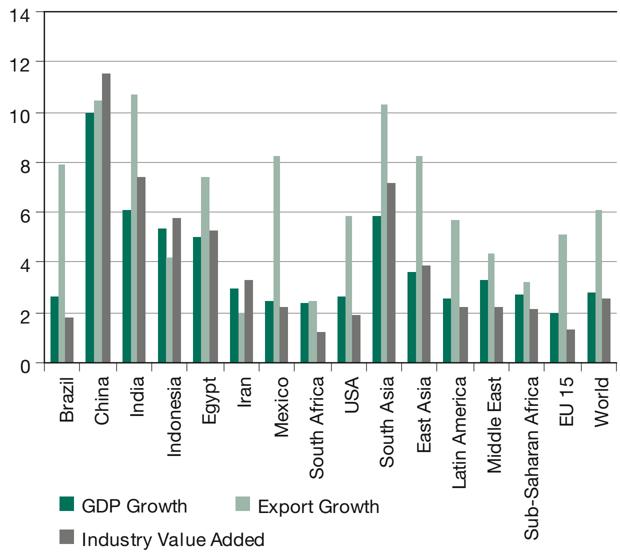
6 See R. Kappel: On the Economics of Regional Powers: Comparing China..., op. cit. and id.: On the Economics of Regional Powers, in: N. Godehardt, D. Navers, op. cit., focusing on the following authors: Joseph Schumpeter, François Perroux, Andreas Predöhl, Charles Kindleberger, Susan Strange, Paul Krugman, Gary Gereffi and others; for a discussion on economic power see C.P. Kindleberger: Dominance and Leadership in the International Economy: Exploitation, Public Goods, and Free Rides, in: International Studies Quarterly, Vol. 25, No. 2, 1981, pp. 242-254; K.W. Rothschild: The Absence of Power in Contemporary Economic Theory, in: The Journal of Socio-Economics, Vol. 31, No. 5, 2002, pp. 433-442; P. Bardhan: On the Concept of Power in Economics, in: Economics and Politics, Vol. 3, No. 3, 1991, pp. 265-277.

7 See in detail R. Kappel: On the Economics of Regional Powers: Comparing China …, op. cit.

Figure 1

GDP Growth, Export Growth, Industry Value Growth, 1980-2009

in %



Source: World Bank: World Development Indicators.

- *Observation 4*: The regional powers account for a significant proportion of global foreign trade; however, Brazil's and South Africa's shares declined over the period shown in the figure. Also important in this respect is the kind of business significant to the economies of the regional powers. Observations indicate that domestic businesses apparently play a much greater role sectorally than foreign trade and investment statistics would lead us to believe. In the SADC, South African businesses seem to dominate the regional value chains through, among other things, buyer-driven chains (South African department stores) and producer-driven chains (breweries, textile production). The same appears to be true of Chinese businesses, but less so of Indian and Brazilian businesses. To date, however, there has been a shortage of empirically rich studies on integration in value chains.[8]

- *Observation 5*: Regional powers have a more differentiated economic structure than other countries in their regions. The value added of the respective manufacturing industries is higher than the region's average.

- *Observation 6*: Regional powers influence 1) the monetary and credit policies of their neighbour countries and 2) regional cooperation.

In addition to the descriptive analysis, we controlled for other variables and thus were better able to evaluate the importance of selected variables.[9] The following results for this sample are robust.

- The base specification clearly shows that sheer size (measured in both total GDP and population size) is a fundamental feature of regional powers. However, regional "superiority" is also very important, as reflected by the coefficient for the GDP per capita (measured as distance from the regional mean).

- When basic variables are controlled for, growth of GDP per capita does not seem to be a determinant of being a regional power. This effect is almost statistically significant.

- The share of exports in GDP does not play a role in shaping a regional power. However, compared to other countries in the respective region, a country with a higher share of exports in its GDP is more likely to be a regional power.

- A higher share of industrial value added in GDP also increases a country's chances of becoming a regional power. The overall results of the regression analysis are mixed, especially with regard to economic performance. Countries that are more industrialised and more export-oriented are more likely to develop their economic influence.

The Regional Powers

Europe is the most important economic area in the world. This also holds true for production (Figure 2). It has the highest share of world income (GDP), but that share has been falling since the 1990s, while China's share has been consistently on the rise. Europe's decline is not an absolute decline but a relative decline – the regional powers grew much faster over the last 20 years than the EU.

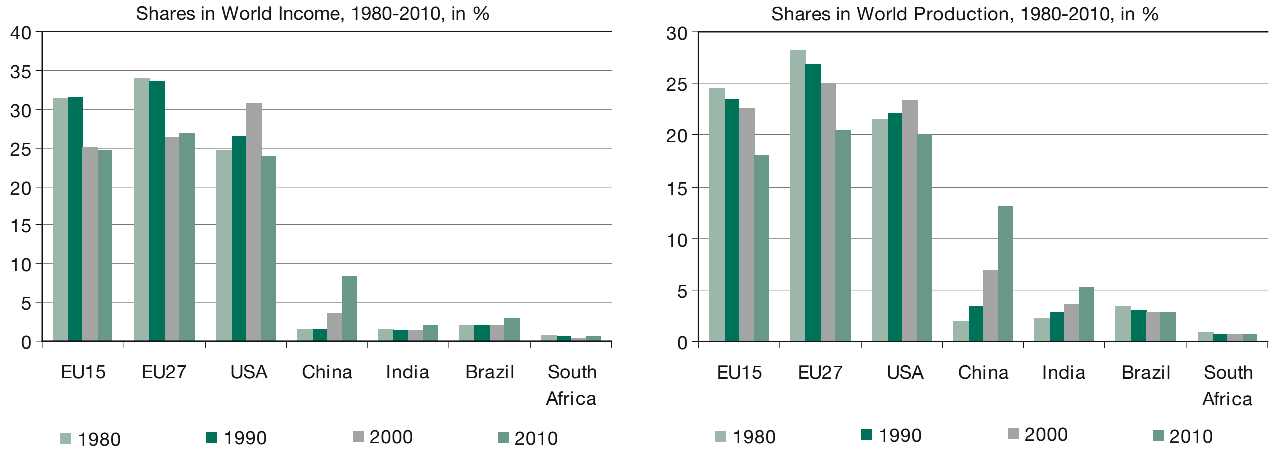
China is the only country that has gained a major global influence in terms of income and production; India and Brazil's shares have remained very low, although India's share of world production is on the rise. The rise of the "East" – China, India and other emerging economies of Asia – can also be demonstrated by the growing influence of Asia as a whole, including Japan, South Korea, Indonesia, Malaysia and Vietnam.

8 T.J. Sturgeon, G. Gereffi: Measuring Success in the Global Economy: International Trade, Industrial Upgrading and Business Function Outsourcing in Global Value Chains, in: Transnational Corporations, Vol. 18, No. 2, 2009, pp. 1-35.

9 For the regressions, we used a simple probit model to produce some stylised facts. The main advantage of the regression approach is that we can control for other variables (for further details see R. Kappel: On the Economics of Regional Powers: Comparing China…, op. cit.)

Figure 2

Shares in World Income and World Production, 1990-2010



Source: based on M. Fouquin, H. Guimbard, C. Herzog, D. Ünal: World Economic Overview, Paris 2010, CEPII, December 2010.

Europe has remained by far the world's most important trading bloc (40% in 2008), followed by North America (16%), and East and Southeast Asia (about 20%). Interesting is that intra-regional trade is very important in the EU (25%), which means that trade among the European countries is very much intra-industry trade (manufacturing products, food, services). This applies even more to intra-Asian trade: two-thirds of East and Southeast Asian trade is intra-regional. This means that, for instance, China's trade developments depend more on Asian trade growth than on trade with the USA and the EU.

In certain parts of the world the European Union has lost shares in trade, but in energy-abundant states (oil, gas) and the most dynamic region of the world – Asia, especially China – its trade shares have been on the rise for more than a decade. The EU is able to take better advantage of the regional powers' growing demand for resources to foster their industrial development. In these countries, the EU has realised rising shares (40%, which means more than a doubling since 1995).[10]

Europe's shares in different sectors are also more or less stable (see Tables 1–4), mostly due to Germany's successful export orientation. The EU holds a key position in services, (including intra-regional trade), accounting for approximately 43% in 2010. China's rise is obvious but not as impressive as has been argued (see Tables 2, 3 and 4). The importance of India's economic position is limited to trade in computer technology and IT services (Table 4).

Europe's position in many parts of the world is challenged by China and other regional powers for the following reasons:

- China's influence in imports and exports is growing globally. This success depends partly on the growing investment of OECD enterprises in China. These foreign-invested enterprises account for approximately 45% of processing and ordinary exports and imports.[11] China's entry into the World Trade Organisation (WTO) in 2001 also supported its economic rise. In processing exports, machinery and electrical products (telecommunications equipment), China experienced outstanding growth, while the share of traditional exports (textiles, footwear, toys) fell to approximately 10% of total exports.

- Europe's trade influence in India, South Africa and Brazil is on the decline. The relative shares of imports from the EU are falling, but China's share of the EU's imports is growing.

- Developing regions and countries are becoming more significant for Brazil, China and India, meaning that the development of the regional powers' economic trade is coming from a deeper trade exchange with developing countries, and not from trade with the EU. Trade among regional powers intensified rapidly (approximately 22% of

10 See G. Gaulier, F. Lemoine, D. Ünal, op. cit., pp. 21-22.

11 Ordinary trade includes imports that enter China and are not incorporated into exported goods. Processing trade includes duty-free imports that are incorporated into exports, or exports that rely on imported inputs. Processing and ordinary trade together account for over 95% of China's exports and 80% of its imports. China's skill content in exports rose because the skill intensity of processing imports rose; for the debate on the technological upgrading of China's industry and the role of export-processing zones see D. Rodrik: What's So Special About China's Exports?, in: China & World Economy, Vol. 14, No. 5, 2006; and R.C. Feenstra, S.-J. Wei (eds.): China's Growing Role in World Trade, Chicago, London 2010, The University Press of Chicago, p. 16.

Table 1

World Trade in Manufactures, Shares in %, 1995 and 2009

	1995	2009
Germany	11.0	9.7
USA	11.8	7.8
China	3.0	7.5
Japan	9.0	5.0

Source: M. Fouquin, H. Guimbard, C. Herzog, D. Ünal: World Economic Overview, Paris 2010, CEPII, December 2010.

Table 2

World Exports in Services, Shares in %, 1995 and 2009

	1997	2008
EU27	43.0	43.0
USA	18.7	14.4
East and Southeast Asia	14.0	15.0
China	1.8	3.9
Germany	6.1	6.9

Source: M. Fouquin, H. Guimbard, C. Herzog, D. Ünal: World Economic Overview, Paris 2010, CEPII, December 2010.

Table 3

World Exports in Transport, Shares in %, 1995 and 2009

	1997	2008
USA	15.2	10.9
Germany	6.2	7.7
Japan	6.9	5.6
South Korea	3.5	5.4
China	0.9	4.6

Source: M. Fouquin, H. Guimbard, C. Herzog, D. Ünal: World Economic Overview, Paris 2010, CEPII, December 2010.

Table 4

World Trade in Computer and Information Services, Shares in %, 1997 and 2008

	1997	2008
USA	18.9	6.2
Germany	11.8	7.6
India	-	24.4
Ireland	-	16.9
UK	12.1	6.7
China	0.5	3.1

Source: M. Fouquin, H. Guimbard, C. Herzog, D. Ünal: World Economic Overview, Paris 2010, CEPII, December 2010.

their exports and 27% of their imports in 2007) but this share is mainly driven by China's imports and exports.[12]

- South Africa developed differently: exports to the EU are growing very fast, while trade with developing countries is declining.

- The EU's share in various groupings of countries (e.g. MERCOSUR, ASEAN, SADC) is also falling. But China, Brazil and India's trade influence in these groupings is limited and growing only a little: China and India are becoming more important in ASEAN but are also getting stronger in many other parts of the world, while Brazil and South Africa have lost influence in their respective regions, partly due to China's involvement in the oil and gas trade and growing exports in those regions.

- The EU plays a more important role in the trade of all BRIC countries than vice versa. Russia is the EU's most important export partner, and the EU is China's most important export partner.[13] Developing countries play a major role (2009: 55%) in China's import structure. This shows that China is dependent on export markets in the West and dependent on imports of raw materials and energy from developing countries.

- The trade of regional powers with developing countries, including resource-abundant countries (oil- and gas-exporting countries, which are also major importers), now plays a dominant role. Exports account for 44% (China) and 58% (India), imports 49% (South Africa and Brazil), 57% (China) and 62% (India). Except for South Africa, the respective shares have shown a phenomenal growth over the twelve years from 1997 to 2009 (see Table 5). This also reflects the ongoing shift of economic power in world trade.

Drivers of Trade

What has driven trade between the EU and China, India, Brazil and South Africa?

In contrast to trade with developing countries (with a share of approximately 60% of EU exports of final goods), the EU has enhanced its position as a supplier of semi-finished goods, parts and components to China, India, Brazil and South Af-

12 G. Gaulier, F. Lemoine, D. Ünal, op. cit., p. 24.

13 P. Havlik, R. Stöllinger: EU's Trade with the BRICs and Competitive Challenges, in: Statistika, No. 2, 2010, pp. 136-157.

rica, while consumer goods are under-represented. In trade with regional powers, intra-industry trade increased, while the share of one-way trade fell (from 89% in 1995 to 76% in 2007). Nevertheless, intra-industry trade with regional powers lags behind trade with other European countries. This shows that geographical proximity and historical ties are important for deeper exchange.[14]

The EU's imports from emerging economies are driven by their industrial policies: China, for instance, established industrial zones and supported the industrialisation and modernisation of the whole country, and opened up its markets to foreign investors. The governments of India, Brazil, South Africa (and others) fostered industrial development[15] and became production bases for manufacturing firms from the EU, Japan and the United States.

The trade position of the EU in regional powers is strong and stable, because European enterprises specialise in high-priced/high-quality goods, which help to maintain market shares. In these categories, the EU recorded trade surpluses, while in low-price segments its share declined sharply.[16]

EU imports from Asia are mainly high-tech products at low prices, a fact that reflects the position of China, which has mainly relied on mass-market standardised goods, although the export structure changed dramatically (more electronics and machinery, but less apparel and fewer agricultural products).[17] These successful sectors rely very much on imported inputs from the EU and the USA, however.

EU imports of mining and quarrying products are important, in particular from Brazil and Russia.

China, India and Brazil have diversified and upgraded their production and maintained their revealed comparative advantages in both labour-intensive industries and agriculture.[18] The EU has maintained and expanded its revealed comparative advantages in all countries in skill-, technology- and innovative-intensive industries. In these fields, the EU succeeded in maintaining its trade surpluses.[19]

14 See ibid.; G. Gaulier, F. Lemoine, D. Ünal, op. cit.

15 P. Aghion, J. Boulanger, E. Cohen: Rethinking Industrial Policy, Brussels 2011, Bruegel Policy Brief 4.

16 G. Gaulier, F. Lemoine, D. Ünal, op. cit., p. 34.

17 As Amiti and Freund show, the skill content of China's manufacturing exports is unchanged once processing trade is excluded. Nevertheless, China's export change was accompanied by increasing specialisation and diversification; see M. Amiti, C. Freund: The Anatomy of China's Export Growth, in: R.C. Feenstra, S.J. Wei: Introduction to "China's Growing Role in World Trade", Cambridge Mass. 2009, NBER Working Paper 14716.

18 P. Havlik, R. Stöllinger, op. cit.

19 G. Gaulier, F. Lemoine, D. Ünal, op. cit., p. 35.

Table 5

Trade with Developing Countries, Shares in %, 1997 and 2009

	Exports		Imports	
	1997	2009	1997	2009
China	45	44	44	57
South Africa	63	48	40	49
India	39	58	43	62
Brazil	39	52	35	49

Source: UNCTAD: Merchandise trade matrix, exports and imports, annual, 1995-2009.

Investment

World foreign direct investments have been growing at an extreme rate since the 1990s. FDI has become the major pillar of internationalisation.[20] The EU has emerged as the most important investor; the major portion of that investment has been intra-EU FDI. Regarding EU FDI flows, the main partners have been the advanced countries (about 85% since the 1990s), and the overwhelming number of EU FDI stocks continues to be there. Only a small portion of EU stocks and flows can be identified in the regional powers (less than 2%, see Figure 4).

An evaluation of the trends shows that there has been only a modest rise in extra-EU investment in Brazil, South Africa, China and India, compared to the steep rise of investment in OECD countries:[21]

- EU FDI flows increased steadily over the period 2000–2009 (see Figure 5).
- The EU's extra-FDI stocks in the regional powers were very low, however (2007): Brazil approximately 3.1%, China approximately 1.2% (excluding Hong Kong with 2.8%), India approximately 0.6%. The combined share of extra-EU outward stocks increased by only 2.5 percentage points to approximately 10% in 2007 (incl. Hong Kong). Hong Kong's share of extra-EU FDI decreased, while China's investment flows increased.
- The share of the EU in inward FDI was very important in Brazil (53%) and India (31%) but of minor importance in China (10%, excl. Hong Kong with approximately 21%). In all regions, the EU is the most important Western investor followed by the USA. Major investor EU countries in India, China, Hong Kong and Brazil are Germany, the United Kingdom, Spain and France.

20 For the data see UNCTAD and Eurostat.

21 See G. Hunya, R. Stöllinger: Foreign Direct Investment Flows Between the EU and the BRICS, Vienna 2009, WIIW Research Reports, No. 358.

- EU outward stocks in the regional powers are concentrated in services and manufacturing – even in the resource-abundant states of Brazil and South Africa, investment in the primary sector plays a minor role.
- Flows of investment from Brazil, China, India and South Africa are growing but not very important (see Figure 5): With approximately 6% of extra-EU inward flows, they are under-represented in the EU. China and India invest mainly in Asia, while Brazil is very active in Latin America and South Africa. China's recent outward activities are noteworthy.[22] Its outward FDI has been growing very fast: $4.5 billion (1990), $17.8 billion (1995) and $23 billion (2009). The global share of FDI stocks, which was extremely low during the 1990s (0.3%), reached 1.2% in 2009. China's outward flows are mainly located in Asia (43% in 2006) and Latin America (48% in 2006). Of all outward stocks, 64% were located in Asia (26% in Latin America), while Europe's share is about 3%.

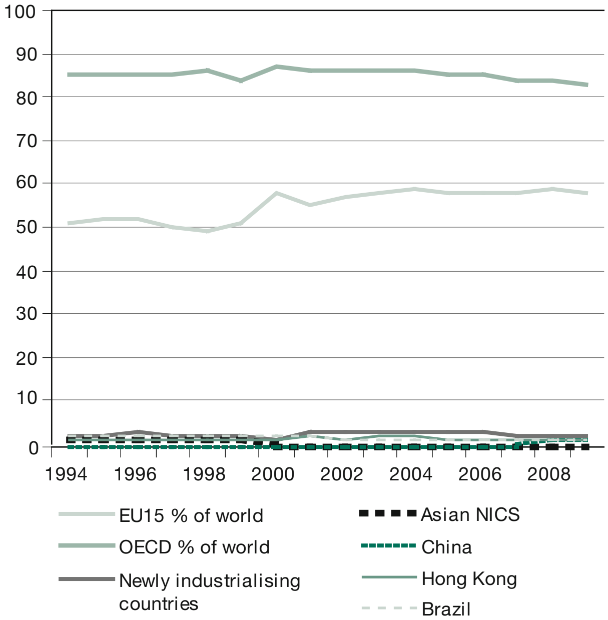
Global and Regional Significance

Without a doubt, the four regional powers observed here play a major role in their regions. India and China are both global actors. The four countries are heavyweights in regional trade, although less so in terms of their regional investment (with the exception of South Africa). They are key players in regional integration, albeit the monetary and integrative leadership achievements have been rather weak – though increasing – except in the case of South Africa. As a result of their strong growth, the regional powers have fostered trade growth in their regions, which has been able to compensate somewhat for the negative effects of cut-throat competition with neighbouring countries.[23] The extent to which development aid, investment funds and other public goods can compensate the disadvantaged countries for the losses suffered should be analysed. To date, however, China, India, Brazil and South Africa have taken on this task to only a limited extent.[24]

One could say of India and China that they have achieved the status of "global economic powers", even though they continue to be viewed as developing or middle-income countries on the basis of their per capita income. In other words, before becoming wealthy they have achieved a very large share of world GDP (measured in purchasing power parity) and economic and political influence due to their size and economic strength.[25]

Figure 4

EU Outward FDI, Stocks, Shares in %, 1994-2009



Source: Eurostat.

China's economic impact is felt worldwide. It needs minerals and oil for its own development, and it acts as a base for manufacturing goods. Its size and growth create challenges for many countries, including other regional powers. China is now an influential economic and political global actor and is, economically speaking, very strongly networked internationally. The growing activities in supra-national institutions (IMF, World Bank, WTO, WHO etc.) are just examples of the growing role of China. China has been successful due to its state-led industrialisation based on a planned economy, protectionism and reliance on market mechanisms, and it has become a self-reliant, independent country and a great power. China is one of the most important importers of energy and today the most important global exporter of manufactured products, which are largely produced by foreign firms located in China. China's exports show a technological level comparable to that of Portugal, which has an income per capita (PPP) that is three times higher, but China's exports

22 See L.K. Cheng, Z. Ma: China's Outward Foreign Direct Investment, in: R.C. Feenstra, S.-J. Wei. China's Growing Role in World Trade…, op. cit., pp. 545-578.

23 This holds especially true for China in neighbouring Asian countries, and South Africa in Southern Africa. China is also a very important competitor in South Africa, India and Brazil, and in many middle powers; for South Africa see L. Rangasamy, J.A. Swanepoel: China's Impact on South African Trade and Inflation, in: Development Southern Africa, Vol. 28, No. 1, 2011, pp. 141-156; for Brazil see R.G. da Fonseca: Getting Real, in: The American Interest, Vol. 6, No. 6, 2011, pp. 20-25.

24 China is a very important aid donor country – not so the others, although they have plans to establish their own aid agencies.

25 D. Rodrik, op. cit., pp. 1-19; D. Rodrik: Making Room for China in the World Economy, in: American Economic Review, Papers and Proceedings, Vol. 100, No. 2, 2010, pp. 89-93; F. Lemoine: Past Successes and New Challenges: China's Foreign Trade at a Turning Point, in: China and World Economy, Vol. 18, No. 3, 2010, pp. 1-23; F. Lemoine, D. Ünal-Kesenci: China and India in International Trade: From Laggards to Leaders?, Paris 2007, CEPII Working Paper 19.

Figure 5
EU's Direct Investment stocks – in € million, EU15)

Source: Eurostat.

remain heavily concentrated on low-tech products (approximately 65% in 2007).[26] Its regional influence is increasing but is still low. China's regional leadership capabilities are rather limited, because the country does not offer enough public goods, and its soft power is quite weak, but its rising involvement in the ASEAN countries shows how much the country is investing in creating a "good neighbourhood".

Brazil presents a mixed picture: it is a middle-income country that has gone through a period of crisis (1981–1993), followed by a period of moderate growth and limited recovery. Its export growth during the last decade was very high – close to 8% on average. Brazil coped well with the financial crisis (as did China and India) and has taken steps to becoming a global power. Economically the country is in the process of catching up, but GNP growth rates and industrial value added in the last 30 years were quite low compared to those of China and India. Nevertheless, its global and regional activities (MERCOSUR integration, climate policy) have been conducive to its accruing great esteem in the "global South" and in the G20.[27] Its economic power is on the rise, but many weaknesses exist (inequality, less dynamism in industrial development). Brazil still exports mineral products and natural resource-based manufactured goods. But its expanding sectors have been the relatively unproductive non-tradable sectors (wholesale and retail trade and services), while manufacturing declined, as did agriculture.[28]

26 I. Bensidou, F. Lemoine, D. Ünal, op. cit.

27 D. Flemes: Brazil: Strategic Options in the Changing World Order, in: D. Flemes (ed.), op. cit., pp. 93-112.

28 M.S. McMillan, D. Rodrik: Globalization, Structural Change and Productivity Growth, Cambridge MA 2011, NBER Working Paper, No. 17143; R.G. Flores Jr.: Brazil Country Report, in: Bertelsmann Stiftung (ed.): Managing the Crisis, Gütersloh 2010, Bertelsmann-Stiftung, pp. 1-26.

India is very weakly integrated into the global economy and the region, but it is catching up based on its high growth rate for exports.[29] It has positioned itself toward medium- and high-range export products (approximately 47% in 2007), and has moved from low-productivity agriculture to modern sectors of the economy. India is without doubt exerting more global influence, but it is not a significant regional player, as its low foreign trade integration and its very low investment in the region demonstrate.[30] India is poor, its infrastructure is hardly developed (roads, harbours, airports, electricity) and only a few sectors are competitive.

South Africa is globally insignificant but is the leading power in its region. Its weak global role is a result of its limited economic growth and, above all, the frailty of its economically weak neighbouring countries. South Africa is taking on the important role of investor and is often the most important investor in the region. It is not very important at the global level because it has a small population and does not play a crucial role in global trade – its share of world markets is even declining due to the falling competitiveness of its export industry. Nevertheless, the country is the only meaningful economic power in Africa and exercises leadership in the region with respect to investment, monetary cooperation and institutional influence.[31]

Brazil, South Africa, China and India are active and dominant in the development of cooperation in their respective regions to very different degrees.[32] Most obvious is South Africa's domination of monetary integration in South Africa through the SACU (South African Customs Union) – which has existed since 1910 – and the Common Monetary Area in South Africa (CMA).[33] The smaller countries in the region profit from the SACU customs revenues through a compensatory mechanism. Within the CMA, the currencies of Lesotho, Namibia and Swaziland are fixed to the South African rand.[34] South Africa is a clear leader in the SACU and the CMA. Brazil has made efforts to advance monetary integration within MERCOSUR; this integration has not yet proceeded very far, however. To date there is no sign of a joint currency and no monetary leadership on the part of Brazil.[35] India's monetary importance in the region has been low to date, something that can be linked among other things to its very limited investment and trade within the region.[36]

Role in International Trade and Investment

For many countries in Asia, China is an important trading partner that stimulates its own exports through direct investment in neighbouring countries, producer- and buyer-driven chains (sub-contracting and economic networks) and an undervalued currency. Although China maintains free trade agreements with ten ASEAN states, something which has led to increasing foreign trade linkages with the region (from 4% in 2000 to 12% in 2009), there is no monetary integration between China and the ASEAN states, and there are no reliable compensation mechanisms.[37] China uses the cooperation within the CAFTA (China-ASEAN Free Trade Area) for its own trade; the low exchange rate has also contributed to its high trade surplus. At the same time, China has started to invest more heavily in the ASEAN countries. Because of the dynamics of China's growth and its increased integration into Asia, its intra-regional trade is growing, for example in ASEAN and also in East Asia. China is simultaneously working toward the regionalisation of the renminbi and has played a stronger role in monetary integration in East Asia since the Asian financial crisis, and a much stronger role since the start of the global financial crisis and the ongoing economic and financial crises in the USA and the EU.

Industrial growth rates have been very different in the observed countries over the last 30 years. While Chinese and Indian industries succeeded because they combined growth with technological upgrading and due to a rise in

29 P. Bardhan: Awakening Giants. Feet of Clay. Assessing the Economic Rise of China and India, Oxford 2010, Oxford University Press; M.S. Qureshi, G. Wan: Trade Expansion of China and India, in: The World Economy, Vol. 31, No. 10, 2008, pp. 1327-1350.

30 R.R. Chaturvedy, D.M. Malone: India and its South Asian Neighbours, Singapore 2009, ISAS Working Paper, No. 100.

31 See R. Kappel: Wirtschaft und Entwicklung in Südafrika, in: W. Distler, K. Weissenbach (eds.): Konsolidierungsprojekt Südafrika. 15 Jahre Post-Apartheid, Baden-Baden 2010, Nomos, pp. 163-185.

32 B. Fritz, L. Mühlich: South–South Monetary Cooperation: An Option for Emerging Markets and Developing Economies to Foster Regional Financial Development?, in: O. Ugarteche (ed.): Beyond Bretton Woods: The Transnational Economy in Search of New Institutions, Basingstoke, Hampshire 2010, Palgrave Macmillan.

33 C. McCarthy: The DADC/SACU Interplay in EPA Negotiations, in: H. Asche, U. Engel (eds.): Negotiating Regions: The EU, Africa and the Economic Partnership Agreements, Leipzig 2008, Leipziger Universitätsverlag.

34 The South African rand is also Botswana's anchor currency; the rand is the reference currency for Zimbabwe's currency; cf. C. McCarthy, op. cit.; B. Fritz, L. Mühlich, op. cit.

35 See B. Fritz, L. Mühlich, op. cit.

36 S. Dutta: The Asian Transition and India's Emerging Strategy, in: N.S. Sisodia, V. Krishnappa (eds.): Global Power Shifts and Strategic Transition in Asia, New Delhi 2009, Academic Foundation.

37 R. Colavecchio, M. Funke: Volatility Dependence Across Asia-Pacific Onshore and Offshore Currency Forward Markets, in: Journal of Asian Economics, Vol. 20, No. 2, 2009, pp. 74-196; L. Zi, C. Jinxia: China and Monetary Integration in East Asia, in: China, Vol. 7, No. 1, 2009, pp. 124-142; J. Sun: Retrospect of the Chinese Exchange Rate Regime after Reform: Stylized Facts during the Period from 2005 to 2010, in: China & World Economy, Vol. 18, No. 6, 2010, pp. 19-35.

total factor productivities,[38] Brazil, South Africa and other regional powers failed to catch up technologically with the leading OECD countries. Due to this technologically determined development based on large markets with economies of scale, only China and India can partly exercise economic leadership. China has invested heavily in R&D infrastructure: R&D spending has increased by approximately 10% each year since the year 2000. In both countries an innovation system is on the rise which will change economic activity, the economic structure and society. However, Japan, Sweden, the USA and Germany remain way ahead in overall innovation capacity.[39]

Our analysis has shown that the regional powers are getting stronger economically. In addition to the economic aspects, we should also refer to the soft and smart power of China, India, Brazil and South Africa. India, for example, describes itself as a global power, although it is unable to take on real global responsibility or create reliable conditions in the region (for example, for defence and security policies in South Asia and in ASEAN).[40] So far, India's "soft-power competence" is small.

China is an exponent of a newly forming world order. Its growing self-confidence in foreign policy is a result of its economic success story. So far, its regional activities and its activities in the international forums are not sufficiently directed at global and regional governance and public goods.[41] China's relations with some of its neighbour states are of a more hegemonial nature. Despite close economic cooperation, there seems to be a higher degree of conflict than cooperation with India (Kashmir, Tibet, Pakistan). China does not yet have enough soft power and has not accrued sufficient esteem. Thus it cannot yet assume a global leadership role. Additionally, the number of its followers is still relatively small.

38 X. Fu, Y. Gong: International and Intranational Technological Spillovers and Productivity Growth in China, in: Asian Economic Papers, Vol. 8, No. 2, 2009, pp. 1-23.

39 The compounded annual growth rate of economic-wide productivity from 1990 to 2005 was 8.78% in China and 4.23% in India; those of Brazil and South Africa were below 1%. M.S. McMillan and D. Rodrik argue that South Africa and Brazil, countries with comparative advantages in primary products, did not develop their productivity as much as China and India, which moved from low-productivity agriculture to modern manufacturing. See M.S. McMillan, D. Rodrik, op. cit.; see D. Ernst: China's Innovation Policy Is a Wake-up Call for America, Honolulu 2011, Analysis from the East-West Center 100. China and India appeared to be more conventional emerging countries; however, they have recently had both rapid TFP and economic growth; see Z. Li: Das chinesische Innovationssystem, Hamburg 2005, Mitteilungen des Instituts für Asienkunde, No. 389; B. Bosworth, S. Collins: Accounting for Growth: Comparing China and India, in: Journal of Economic Perspectives, Vol. 22, No. 1, 2008, pp. 45-66.

40 N.S. Sisodia, S. Datta (eds.): Changing Security Dynamics in Southeast Asia, Delhi 2008, Academic Publishers.

41 On the ongoing debate in China see W. Jisi: China's Search for a Grand Strategy, in: Foreign Affairs, Vol. 90, No. 2, 2011, pp. 68-79.

Perspectives

What do the findings on the economics of the regional powers presented here mean for the changes in the world economy? (1) The regional powers are of outstanding importance for future economic global developments. (2) Those countries that are entering higher-value growth markets – like China and India – are deepening their economic influence on their regions and on the world. The resource-dependent countries South Africa and Brazil, on the other hand, are of minor importance in the world economy. (3) Being a regional power also means making advances in research and technological upgrading and productivity, which in turn enhances the regional power's appeal. All the regional powers, except China, face major problems in their technological catching-up processes, due to low levels of education and the low average dynamism of their enterprises.[42] (4) If the regional powers practise soft and smart power and increasingly provide public goods, and if they are able to make other countries follow their lead, they can become agents of change, thus gaining increasing influence in global affairs and in the region. So far, the regional powers discussed in this paper have been prevented from playing a more active role in the region and in global affairs by their own internal weaknesses and vulnerabilities.[43] And so far they have lacked defined and comprehensive global and regional governance strategies. If they continue to grow as they have over the last few decades, if they form effective alliances and if they build up the above-mentioned capabilities (soft power, networks, provision of public goods), they can shift global distribution and end Western domination. They can also be strong partners in the global economic order. Clubs like the BRICS (including South Africa) or IBSA could become more powerful, reshape the world and contribute to global and regional solutions to problems including climate change, energy security, peace, stability, monetary integration, poverty reduction and development. The regional powers have emerged primarily in the economic realm but not as smart powers.[44] (5) Bra-

42 Their low spending in R&D (except China) limits the catching-up and convergence.

43 India's high and rising poverty, Brazil and South Africa's high inequality, China's authoritarian regime, the huge transformation processes in urbanisation, migration, and the ageing of the population.

44 P. Nel: Redistribution *and* Recognition: What Emerging Regional Powers Want, in: Review of International Studies, Vol. 36, No. 4, 2010, pp. 951-974; G. Chin, R. Thakur: Will China Change the Rules of Global Order?, in: Washington Quarterly, Vol. 33, No. 4, 2010, pp. 119-138; H.W. Maull: World Politics in Turbulance, in: Internationale Politik und Gesellschaft, No. 1, 2011, pp. 11-25; S. Halper: The Beijing Consensus: How China's Authoritarian Model Will Dominate the Twenty-First Century, New York 2010, Basic Books; A. Hurrell: Regional Powers and the Global System from Historical Perspective, in: D. Flemes (ed.), op. cit., pp. 15-27; S. Destradi: Regional Powers and Their Strategies: Empire, Hegemony, and Leadership, in: Review of International Studies, Vol. 36, No. 4, 2010, pp. 903-930.

zil, China and India are important forces in the development of international technical and economic norms and standards[45], in international security, in peace missions in conflict regions, in climate and energy politics, and in issues related to currency and the global economy. They also have an increasing influence within international organisations (WTO, WHO, UN). They are, like South Africa, members of the G20. (6) As numerous studies illustrate, the power of states no longer depends only on economic and military power, but rather on soft power, that is, their networking capacity vis-à-vis other states. The state is becoming a "network agency." Migrant networks, universities' allure, research and cultural exchanges, economic cooperation and non-state networks limit the influence of states more strongly than previously assumed and are making clear how much global networks influence states – for instance, non-state development organisations; pro-fair-trade groups; and the actions of politically active groups such as Amnesty International, Greenpeace, Oxfam and Transparency International. The standardisation of technical norms; the worldwide establishment of labour, environmental and human rights standards; codes of conduct for businesses, such as corporate social responsibility (CSR); and the expansion of public-private partnerships demonstrate transnational networks' increasing scope of political action. In these fields the EU and the USA are much stronger than the regional powers.[46]

Consequences for Europe

The EU, the USA and Japan have lost market shares globally and in most of the regions, but the EU has been successful in defending its role as the biggest economic bloc and the most important trading area in the world. This success is mostly due to the rising shares in trade with China and with oil- and gas-producing countries, and the high growth rates of trade with Russia and the EU's neighbouring countries. It is strong because of very high investments worldwide, and because of its focus on manufacturing, on high-priced, skill-intensive production, and on technologically sophisticated production.

The EU (15 and 27) is a major global economic and political actor. It has significant economic power (income, industry, productivity, technology, education system, etc.), hard power (economic plus military power), and soft power (business networks, cultural institutions, diplomacy and migrant networks, academic networks), but lacks smart power.[47] A debate is currently taking place as to whether the EU is an attractive model and a global actor. Anne-Marie Le Gloannec[48] emphasises that the EU is also a regional power, and the EU's soft power is backed by a formidable economic structure which attracts other countries to merge with it. Andrew Moravcsik makes it clear that the EU is both a hard and a soft power. The EU's civilian and military power capabilities have increased: "In many ways Europe is optimally suited to project power in the contemporary global system."[49] Others point out the inconsistencies in the EU's presence, capabilities and patterns of behaviour. Without going into detail, we can state that the EU faces a lot of very severe economic, financial and political problems, and its smart power is limited.

- The Lisbon strategy of 2000 stated that by 2010 Europe was to become the most competitive and most dynamic knowledge-based economy of the world. However, the implementation of this aim has failed due to the single-minded actions of particular nations, a lack of implementation mechanisms and incoherent strategies. Nowadays, declining productivity, weak growth, structural unemployment, lack of flexibility in the employment market, demographic decline, the ageing of societies and insufficient immigration are major challenges for the EU. These developments are supplemented by very deep financial, economic and political crises in several countries (Portugal, Greece, Ireland, Italy and Spain) and in the European Economic Area.
- In comparison to the USA, the EU is relatively weak in the areas of the military, diplomacy and foreign policy and is even unable to bring its political and economic weight to bear in the neighbouring Mediterranean area or with regard to the Middle East, North Africa, China, India and the other regional powers. In 20 years it has not been able to establish a coherent policy for Turkey, and its migration policy is highly controversial. Numerous other examples for a waning EU could be enumerated.

45 R. Foot, A. Walter: China, the United States, and Global Order, Cambridge 2011, Cambridge University Press.

46 See C. Jakobeit, R. Kappel, U. Mückenberger: Civilizing the World Order? The Scope and Potential of Transnational Norm-building Networks, GIGA Focus International Edition, No. 1, Hamburg 2010, GIGA; U. Mückenberger: Civilizing Globalism: Transnational Norm-Building Networks as a Lever of the Emerging Global Order?, in: Transnational Legal Theory, Vol. 1, No. 4, 2010, pp. 523-573.

47 Nye defined smart power as "the ability to combine hard and soft power resources into effective strategies"; see J.S. Nye, op. cit., p. 23.

48 A.-M. Le Gloannec: The European Union as a Regional Power, in: N. Godehardt, D. Nabers (eds.), op. cit., pp. 95-113.

49 A. Moravcsik: Europe: Quietly Rising Superpower in a Bipolar World, in: A. Alexandroff, A. Cooper (eds.): Rising States, Rising Institutions, Washington 2010, Brookings Institution Press, pp. 151-174.

- The final and most important argument is the fact that the EU is largely preoccupied with itself. In the globalisation process it no longer enjoys the respect of others as a model. Eurocentricity prevents Europeans from playing a global political role. The predominant inward gaze makes them substantially less appealing in the eyes of their neighbours (Mediterranean states) and also less appealing for African states that are turning to China et al. instead of turning to Europe. In even more remote countries, Europe displays an economic presence (for example, Germany as an investor and exporter) but has no significant political influence due to its inability to take on a "non-European perspective".[50] Nevertheless, the EU as the biggest economic bloc has a pivotal position in the international economic and political order, even though it is facing instability and a relative decline in political and economic power.[51]

The further rise of the new regional powers will certainly not be linear due to exceedingly inconsistent internal situations. Economic growth, the size of the population and the size of the country do not automatically entail regional, let alone global, leadership. The requirements are far higher: reliability, trust of one's neighbours, *soft and smart power* and the provision of public goods for the region and worldwide. It is obvious what the new regional powers lack, and the lessons they will probably learn in the near future are plain to see: a regional power needs to possess the ability to lead globally or even just regionally and to make global public goods available. They too rarely take global and regional responsibility. Their policies are too unreliable for generating trust in the non-OECD world, and also in the EU and the USA.

In the wake of these developments, the transition to multipolarity might not be as likely to occur as some authors argue. The strategy of the West of integrating Russia and China through cooperative relations in order to eventually return to unipolarity (with the USA as the leading power) has failed, however, due to strongly levelled power relations between the USA, the EU and the regional powers. Collisions of geostrategic interests and interests concerning energy and economic policies are occurring increasingly. China demands a multipolar currency order which is to supersede the US dollar as the leading currency. It is precisely the weakness of the US dollar and the euro concurrent with the increase in the significance of the Chinese currency which leads to uncertainty and insecurity in the global economy.

In the G20, regional powers often take positions in diametrical opposition to the ideas of the traditional powers, which is most obvious with regard to climate policy, economic protectionism, industrial policy, the global supply of energy and, in particular, values. In this context, it makes no sense to pretend that the increase in their wealth also entails their readiness to comply with the West on all issues. The opposite is the case: the non-unified West will have to learn that China, Brazil, India and other states will refuse to take orders on how to conduct economic, political and cultural matters etc., let alone simply adhere to Western values and norms, which often display both ambiguities (human rights and their application) and endeavours for dominance and exploitation.

Indeed, regional powers are aspiring to a new order of global politics; they no longer want to be followers. They are forming new alliances, and countries such as Turkey, Indonesia, Venezuela, Iran, South Africa, India and Brazil no longer wish to be taken in tow by the USA. To a hitherto unprecedented extent, they resent external hegemony. They themselves now try to lead; they clearly attend to their own interests and they are not prepared to compromise at all costs, e.g. in agricultural negotiations, world trade, currency, world health, and membership in the IMF, WTO and the World Bank.

Currently the West is not solving enough global problems. Europe makes many promises, but the incoherence of its foreign policy and security policy weakens its ability to act decisively. Despite strong positions in international organisations and despite high economic standards and its significant role in global trade and investment, the "Club of the West" is increasingly losing its ability to lead and govern. In many ways, Europe is succumbing to the belief that it can continue without adapting. But the rise and dynamism of the "new" is here. European foreign policy is inhibited. The tendency to act on single state policies illustrates its weakness. In order to avert further decline and to play a major role in the coming decades, the EU must develop coherent European policies for foreign affairs, foreign trade, climate issues, energy, finance, currency, migration and technology for democratic values. In other words, it must enhance its economic, hard, soft and smart power. It will also have to learn to act and solve global and regional problems with the regional powers in the context of a mutual discourse on obligations.

50 H. Mayer: The Long Legacy of Dorian Gray: Why the European Union Needs to Redefine its Role in Global Affairs, in: European Integration, Vol. 30, No. 1, 2008, pp. 7-25; see H.W. Maull, op. cit.

51 R. Kappel: The Decline of Europe and the US: Shifts in the World Economy and in Global Politics, GIGA Focus International Edition, No. 1, Hamburg 2011, GIGA; J.W. Legro: The Omnipower: The United States and Regional Orders, in: N. Godehardt, D. Nabers (eds.), op. cit., pp. 175-192.