Chapter 1

Seeing the Elephant in the Twenty-First Century

Progress is impossible without change, and those who cannot change their minds cannot change anything.

—George Bernard Shaw

There is a traditional Hindu fable in which several blind men encounter an elephant for the first time. One man feels the trunk and states the elephant resembles a snake; another touches the tail and is convinced the elephant must be like a rope. A third man grabs an ear and compares the elephant to a fan, while another pats the belly and believes it to be like a wall. The blind men start arguing, each insisting that he alone is right. A man passing by asks what the commotion is all about, and the blind men reply, "We can't agree on what the elephant is like." After hearing them all, the bystander calmly explains that each of the men is describing a piece of the animal correctly, but not one perceived the elephant in its entirety. The blind men leave feeling both vindicated and enlightened.

By titling this book *Seeing the Elephant*, I'm hoping to underscore not that conventional views on globalization—our elephant—are parochial or untrustworthy but rather to emphasize that all reasonable perspectives add value to this important dialogue. Because, when it comes to globalization, perceiving the big picture is just as essential and maybe more important than focusing on one or two areas. The title also refers to the expression "the elephant in the room," that is, an uncomfortable situation where something major is on everyone's mind, but no one says or does anything about it. Globalization is enormous and a bit frightening, so many people choose to ignore rather than confront it.

The extraordinary changes of the last century—the ways we work, eat, communicate, stay safe, and entertain ourselves—are multifaceted, yet also form a coherent whole. Today's elected officials, corporate and financial titans, media commentators, and scholars have taken a magnifying lens to various aspects of the dramatic changes of the past 20 years, providing useful snapshots of information. But we still struggle to see the how the parts are linked together.

The result of these incomplete efforts is a checklist of worries instead of a logical plan for tackling our thoroughly new challenges. When the Twin Towers topple, we fear global terrorism. Al Gore wins an Oscar for *An Inconvenient Truth*, and we fixate on global warming. An Indian customer service representative answers our toll-free call in Bangalore, and we add outsourcing to the worry list. Brazilian supermodel Gisele Bündchen demands to be paid in euros, then a weak dollar grabs the headlines. Gas rises above $4 a gallon, we proclaim an energy crisis. We discover tainted shipments of Chinese pet food, and protectionist tempers flare. We see pictures of George Clooney, Bono, or Angelina Jolie in Africa and add genocide, poverty, and AIDS to our anxieties. Lehman Brothers goes bust, and we worry if our savings accounts are safe.

This patchwork of international problems deserves more than the scattershot attention it now receives. The parts of the elephant—poverty, energy, business, environment, and security—need to be understood as a systematic whole. Americans can no longer avoid this elephant. While globalization is incredibly complex, the meteoric rise of economic powerhouses and nonstate actors demand new forums where tough questions and policy prescriptions can be discussed. But first, let's look at the path we followed to where we are today.

What's Old Is New Again

Walking through the thirteenth century, one would be surprised by how similar lifestyles were in Mesoamerica, continental Europe, Africa, and Asia. The key bio-social markers of progress—life expectancy, daily caloric intake, infant mortality rates, literacy—were fairly similar in ancient Mexico City, London, Istanbul, and Beijing. Most people farmed, went to market, lived, and died close to where they were born. Family size was roughly similar in each location (that's to say large), and no civilization looked much better off than another. Certainly no country back then could be considered rich by today's rubric. Compared to our modern existence, Hobbes was right: Life was nasty, brutish, and short.

With the advent of the Renaissance, a renewed interest in learning helped Europe break free from the Dark Ages. This led to the watershed late eighteenth-century invention of steam power in Great Britain. Adam Smith's 1776 *Wealth of Nations* provided the philosophical framework for organized capitalism, and the Industrial Revolution was born. Machine-driven capacities dwarfed animal and human labor, output soared, and costs declined. Trade accelerated as improved canals and railways and the invention of the internal combustion engine allowed more goods to move farther, faster. Great Britain's mass education system generated skilled workers capable of operating the new mechanical inventions. After millennia of struggling with scarcity, Homo sapiens had found a formula for producing abundantly while working less.

Great Britain was the first industrial economy, but its lead did not last for long. Goods, ideas, and formal education spread throughout Europe and North America in the late nineteenth and early twentieth centuries leading to the convergence of living standards (or flattening as Tom Friedman might say). By the late 1800s, poor countries around the southern European periphery—the emerging markets of their day—were growing fast, catching up to the rich industrial leaders at the European core.

Asia did not join the action until late in the nineteenth century, when the establishment of the Suez Canal, innovations in marine transport, and penetration of the continent's massive interior by railroad liberated it from the tyranny of geographic isolation. Thereafter, the West rapidly engaged Asia in exchange. China opened its ports in 1842 and Thailand in 1855, both with small tariff barriers. India followed Britain's free trade model in 1846, and Indonesia mimicked Holland in 1870. The most dramatic change, even by the standards of the recent Asian Miracle, occurred in Japan, which went from being an isolated feudal country to an open economy in the mid-1850s. Some 15 years after the arrival of Commodore Perry, Japan's foreign trade rose from 0 to 7 percent of national income, which itself grew an estimated 50 percent![1]

Outside of Japan, Asian nations' living standards continued to lag. These countries' huge populations, with education and literacy trailing the West, left them unable to switch from manual labor to machinery-based economies. From the dawn of Industrial Revolution through the late twentieth century, per capita income in India relative to Britain dropped from assumed parity to 15 percent, a fall of 85 percentage points.[2] India and China had already lost ground to the U.K., United States, and Russia that they would not start to regain until the 1990s. (See Table 1.1.)

In the late nineteenth century, after a half-century of open trade and relatively peaceful relations throughout the continent, short-sighted politicians across Europe began erecting commercial barriers. A lack of forums for cross-border economic coordination led to distrust and misperception. Trade competitiveness and protectionist policies resulted, countries started forming alliances and blocs and markets ended culminating in military conflict, commercial stagnation, and 30 years of destruction. In World War I, 28 million people were injured

Table 1.1 Historic Power Shifts, 1820–2050 (Percentage of Global Economic Output)

1820	1870	1950	2000	2050
China 33%	China 17.2%	US 27.3%	US 22.2%	China 28.1%
India 16%	India 12.2%	USSR 9.6%	China 14.6%	US 21.9%
France 5.5%	UK 9.1%	UK 6.7%	Japan 6.6%	India 17.2%
Russia 5.4%	US 8.9%	Germany 6.5%	India 5.9%	Japan 4.8%
UK 5.2%	Russia 7.6%	China 5.0%	Germany 4.1%	Brazil 4.4%

SOURCE: OECD, Goldman Sachs.

and 13 million people died, with military costs and property destruction the equivalent of trillions of dollars. The bleak intrawar years brought further protectionist measures. As tempers flared among trading partners, a worldwide depression set in, allowing for the rise of fascist and nationalist movements, and ultimately leading to World War II. The Second World War's death toll totaled between 50 and 70 million including fatalities from famine and disease.[3] More than $1 trillion was spent by countries in combat and an estimated $3 trillion in property was destroyed.[4] Not until well after World War II did trade begin to approximate the late nineteenth-century volume.

The Postwar Period: An Uneasy Peace, an Uneven Global Economy

After the destruction, chaos, and economic stagnation of the two world wars, a new era of stability dawned. The United States emerged as a superpower, leading unprecedented multilateral efforts across the realms of trade, security, and finance. In the years following World War II, the United States engineered multilateral hallmarks, including the Bretton Woods Agreement on monetary and financial coordination, the United Nations, the World Bank group, the International Court of Justice, the General Agreement on Tariffs and Trade/World Trade Organization (GATT/WTO), the predecessor to the Organization for Economic Cooperation and Development (OECD), and the North Atlantic Treaty Organization (NATO). Whereas the late nineteenth-century trade boom had been largely unregulated, these neoliberal, free-market-oriented institutions shined as beacons of hope to counter the postwar socialist, centrally planned approaches of the Soviet Union and much of Asia (including China), Latin America, and Africa. By setting protocols for the orderly exchange of goods apart from the authority of any single ruling country, they insured mutual prosperity and security. A quantum leap in living standards resulted, creating a massive socio-economic gap between the Western camp and the rest of the world. Between 1945 and 2000, not only did the per capita gross domestic product (GDP) of the United States and Western European countries grow several times faster than that of the socialist/communist world, but Westerners were living longer and were generally healthier as well.[5]

In 1974, the United States took multilateralism to the next step, creating the Library Group, an informal gathering of senior financial officials from the United States, the United Kingdom, West Germany, Japan, and France. This casual forum for the world's leading industrialized democracies was to become a steering group for global policy. The countries agreed to an annual meeting under a rotating presidency, forming the Group of 6, or G6, which later added Canada to become the G7. For the next 20 years this forum would manage economic and financial interactions but also touched on defense and security issues.

During the 1970s and 1980s, the G7 was *the* world's dominant economic and political power bloc, with several smaller trading nations slowly grafting themselves to the system including the four "Asian Tigers": Hong Kong, Singapore, Taiwan, and South Korea. These countries had adopted similar policies to Japan's "educate and export" model. It took the Japanese only 50 years to cultivate mandatory universal education (versus 150 years in the United Kingdom and 100 years in the United States), but South Korea cut this to roughly 30 years. All the Tigers focused on education. (See Figure 1.1.) By leveraging their relatively cheap but skilled workforces, they posted unprecedented double-digit growth and trade integration for nearly three decades.

For much of the postwar period, authoritarian nations like the former Soviet Union and Communist China opted for central planning and domestic protectionist policies over free trade. When the Soviet Union finally collapsed in 1991, it tolled the death knell of centrally planned economies. Then China generated dramatic momentum in the 1980s with Deng Xiaoping's vision of a "socialist market economy." With a large population and nearly 80 percent literacy, China didn't have 12-year compulsory education like the Tigers or Japan, but its sheer size allowed its economy to integrate into the global economy. By accepting more than $250 billion in private foreign direct investment from U.S. and other G7 multinational corporations, China used the 1990s to build up world-class manufacturing capabilities as the Four Tigers did in previous decades, posting similar double-digit growth rates that continue today.

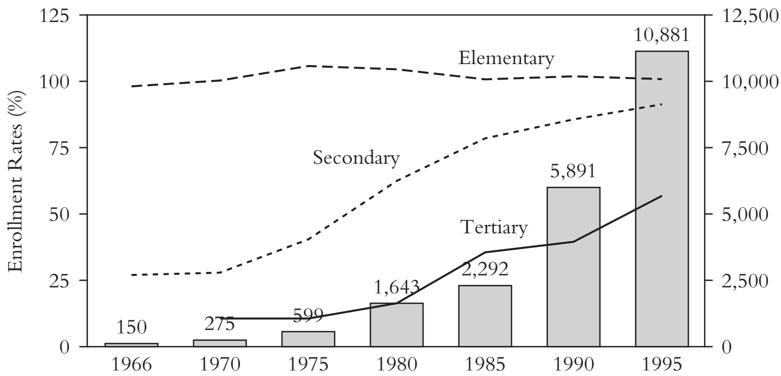

Figure 1.1 Education and Wealth: South Korean Enrollment Rates vs. Economic Growth, 1966–1995
SOURCE: IMF, World Economic Outlook 2001.

In Latin America, reform and privatization in Chile, Mexico, and Brazil, along with massive debt cancellation and restructurings through the Brady Plan, helped restore sovereign solvency and paved the way for greater global integration. Similar progress in statist South Asia—particularly India—could be witnessed. Africa, while slower than other regions, also trended toward privatization and integration programs, with South Africa emerging successfully after apartheid ended in the early 1990s.[6]

Several free trade converts, such as China and India, rapidly closed postwar living standard gaps in one of the greatest socio-economic convergences of all time. In developing countries, many indicators—education, life expectancy, daily caloric intake—began approaching G7 levels and will catch up sometime this century (see Table 1.2).

New Multipolar Power

After the Soviet Union's 1991 collapse many critics proclaimed the United States as the world's sole "hyperpower," the dominant global leader on all fronts. However, power by any definition has shifted in the twenty-first century. Consider economic power: the United States may be at the top, but other nations are nipping at its heels.

Table 1.2 Global Convergence, 1950–2050

		1950	2000	2050E
% of Global GDP	Emerging Markets	5	25	55
	Advanced Countries	95	75	45
% of Global Financial Capital	Emerging Markets	3	12	68
	Advanced Countries	97	88	32
Life Expectancy (years)	Emerging Markets	41	64	78
	Advanced Countries	65	77	83
Daily Caloric Intake	Emerging Markets	1200	2600	3000
	Advanced Countries	2200	3100	3200
Infant Mortality, (per 1000)	Emerging Markets	140	65	10
	Advanced Countries	30	8	4
Literacy Rate (per 100)	Emerging Markets	33	64	93
	Advanced Countries	95	98	99

SOURCE: Bloomberg, World Bank, UNDP, Goldman Sachs and author's estimates. GDP and stock market capitalization figures are inflation adjusted.

Japan is one of the largest world economies, dominating industries from automobiles to electronics. Much of Europe has evolved into the European Union (EU), a potent free-trade zone-*cum*-political union. The eastern European countries once left to languish under Soviet auspices have experienced rapid trade growth—many will eventually merge into the growing EU marketplace. China, after nearly 20 years of reform, now wields growing international political and economic clout and is on target to be the largest economy later this century. India, too, has shed its statist development model and emerged as a rising star. Elsewhere, Brazil, Mexico, Turkey, South Korea, and others in Asia have become major global trade participants. South Africa, Egypt, and Nigeria have become regional power brokers. With the spike in global economic activity, demand for energy has vaulted many Middle Eastern petro-states into the world's center ring along with Russia. In short, the United States and the other G7 members are no longer the locus of economic activity.

Dramatic advances in technology (particularly in telecoms and computing), the abandonment of centrally planned statist philosophies, the adoption of free market policies, and the cultivation of relatively youthful, better-fed and better-educated populations in developing countries have led to the success of many emerging states. Better human capital in developing countries—growing populations with improving living standards—is narrowing the West's lead. According to the United Nations Human Development Index (HDI), in 1960, lower and middle income countries posted HDI levels of only 20 percent and 32 percent of high income nations.[7] By 1993, these indicators grew to 34 percent and 62 percent, and in the latest spurt of globalization, by 2006, they had climbed to more than 65 percent and 85 percent, respectively. Already, the nations of what I have termed the "Emerging 7" (E7)—China, Russia, India, Indonesia, Mexico, Brazil, and South Korea—have a combined population of more than four times that of the G7 nations. By 2050, their populations will be more than five times greater, as birth rates slow in the G7. Some countries, like Germany, Italy, and Japan may even shrink in population. In the same period, the aggregate GDP of the E7 nations will be twice as large as the G7, as Table 1.3 shows.

These E7 nations are by no means the only emerging markets worth watching, but they do offer an interesting mix of risk and reward that demands serious attention for longer-term public policy formulation.[8] The prosperity that these and other formerly poor countries have gained thanks to globalization offer the United States and the G7 novel opportunities—but only if we understand the trends and engage emerging powers constructively.

The E7 and Other Rising Powers

The G7 is a chummy clique of influential and wealthy states. But with growing populations of skilled workers and consumers, many countries outside this elite club are increasingly important in the global trade system. The policies of these rising powers affect U.S. and European economies and vice versa. The E7's collective economies are already about 75 percent of the G7 on a purchasing power parity (PPP) basis,

Table 1.3 G7 vs. E7 by the Numbers

	Current Population	Est Population in 2050	Current Economy (billions, PPP)	Est Economy in 2050 (billions, PPP)
United States	295,734,134	467,480,550	$12,454	$37,666
Japan	127,417,244	124,283,183	$3,942	$8,040
Germany	82,431,390	80,395,649	$2,417	$5,440
France	60,656,178	72,957,719	$1,829	$4,870
United Kingdom	60,441,457	69,510,624	$1,926	$5,067
Italy	58,103,033	56,668,110	$1,667	$3,128
Canada	32,805,041	51,345,087	$1,061	$2,983
G7 Totals	**717,588,477**	**922,640,923**	**$25,296**	**$67,194**
China	1,306,313,812	1,744,331,739	$8,572	$48,571
India	1,080,264,388	2,164,849,996	$3,815	$27,235
Indonesia	241,973,879	497,016,784	$847	$3,923
Brazil	186,112,794	315,312,308	$1,627	$8,028
Mexico	106,202,903	189,987,001	$1,052	$7,838
South Korea	48,422,644	58,533,982	$1,056	$3,684
Russia	143,420,309	119,156,344	$1,559	$6,162
E7 Totals	**3,182,371,288**	**5,208,971,595**	**$19,140**	**$105,441**

but by 2050 they will be nearly twice as big, as Table 1.3 shows. And the E7 are more than export-reliant economies like the smaller Asian Tigers; they are large countries with growing populations, some with sizeable armies and nuclear weapons, and they should be incorporated into the world's multilateral governing bodies. Consider them country by country:

China: This 5,000-plus-year-old civilization was the world's largest economy in 1820 and should be again by 2050.[9] With enormous, skilled workforces in both low- and high-tech sectors, China has already surpassed the United States as the leading exporter to Europe, leaving its trade partners to ask, when will its artificially cheap currency become more freely traded and fairly valued? On the security front, while China has long been a nuclear superpower, it has quietly stayed out of military skirmishes for decades. Will and should this continue? With nearly $2 trillion in hard currency reserves, China is one of the world's largest buyers of U.S. government bonds, and many Chinese companies (some with state-ownership) are aggressively acquiring overseas assets. This will be *the* crucial relationship to forge in the coming decades.

India: The second largest economy in 1820, India is an amalgamation of a high-tech aristocracy that rivals Silicon Valley for its multitude of engineers and computer specialists[10]; a growing 50-million-person middle class that matches in size some G7 members; and a near-permanent underclass that constitutes 10 percent of the Earth's population. When you combine India's mix of Hindu and Muslim populations, colonial past, nuclear weapons, and the world's largest functioning, English-speaking democracy, one can see why this giant should be a greater part of our multilateral system of governance.

Brazil: South America's largest economy covers more square miles than the continental United States' 48 states and has over 160 million inhabitants. While bogged down by poorly performing and corrupt state-owned enterprises in the past, Brazil now has a diversified economy spanning agriculture to aviation and is the world's leading ethanol producer. Brazil also has taken the lead in trade discussions related to the global roadblock over agricultural subsidies. Brazil exerts strong regional influence and can have a stabilizing effect on other Latin countries, notably Venezuela, Bolivia, and Argentina, where more populist and nationalist politicians have made headway in recent years.

Russia: Ten years ago, Russia was nearly bankrupt. Yet the 150-plus million people of the former world power bounced back faster and stronger than anyone predicted. Russia holds the world's third largest foreign reserves. While a member of the G8, it is still excluded from G7 financial and trade discussions. Russia has sought greater global influence by exploiting its abundant natural resource reserves. With a revived economy, what are Russia's true intentions on the global scene? With the country's permanent status on the U.N. Security Council and improved financial footing, isn't the country worthy of increased dialogue and coordination?

Indonesia: Think about Islam and the Middle East comes to mind, yet Indonesia's 245 million people comprise a quarter of the world's Muslim population. This large nation has significant oil reserves and a skilled workforce but also ethnic tension spread across hundreds of islands in the southeast Pacific Rim. Already one of the world's 20 largest economy, Indonesia will be among the world's top seven economies by 2050. Understanding and working with this complex nation could help the G7 in future dealings with the Muslim world.[11]

Mexico: Already one of the United States' largest trading partners, Mexico has become even more interlinked since the North American Free Trade Agreement (NAFTA) was signed in 1993. With a population of nearly 110 million, Mexico is in the thick of the U.S. immigration debate.[12] We also should not take its free market and democratic status for granted. It is possible that Mexico can slip back to its socialist, statist past if ignored by the United States. Mexico should be viewed as a partner promoting greater global integration in Latin America and the Caribbean.

South Korea: Fifty years ago, South Korea was among the planet's poorest countries. Today, it is the 13th largest economy in the world. A longtime U.S. ally, South Korea sits in a geographically important corner of East Asia, though recent strains over policy toward Pyongyang have led to growing resentment of the U.S. military presence. Given its world-class corporations and its strategic location, greater inclusion of South Korea in global forums seems clearly warranted.

These seven countries represent huge segments of the world's population and a convenient standard of comparison to the G7, but by no means are they the only important emerging powers. In Africa, oil-rich Nigeria with more than 120 million people, Egypt with 70-plus million people, and wealthy South Africa are clearly important countries in a continent that is showing more promise everyday. Many central European players like Poland, Romania, Ukraine, and Turkey—with 200 million people in total—are rapidly pushing for EU integration. In Asia, several smaller countries like Singapore and Taiwan, along with larger ones like Thailand, Malaysia, and newcomer Vietnam, have vital economic and financial places in the world's economy.

The Rise of Nonstate Actors

Alongside the rise of new sovereign powers, the increasing prominence of nonstate actors (NSAs) have also complicated cross-border relations. There have always been a few civil players that were part of cross-border activity—missionaries, merchants, and explorers. Today, a remarkable variety of NSAs are active globally. Some of these players are loosely regulated and monitored by governments, but most are independent on a day-to-day basis. Understanding what they are, how they function, and how they can be influenced will be perhaps government's greatest challenge in policy making.

Multinational Corporations: Totaling over 100,000, multinational corporations (MNCs) are the economic emissaries of the modern world, seeking higher profits by scouring the globe for cheaper labor and new consumers. Today, it is common for production and supply chains of these corporate giants to cross not one but several borders. MNCs like GE and Nike have built tens of thousands of factories globally, employing millions of people. Some companies today are large and complex, and many have greater revenues, employees, and customers than some nations.[13]

Financial Institutions: The globalization of finance has accelerated briskly in the last two decades. In 1980, roughly 73 cents of every dollar that went from the first world to developing countries came from a couple of dozen commercial banks and the World Bank; there were no meaningful emerging market stock and bond markets attracting investor capital. Today, the amount of money and number of players can barely be calculated. As the current credit crisis underscores, our 24/7 system of finance now includes not only thousands of regulated intermediaries—like banks, brokerage firms, insurers, mutual funds, and pension funds—but many new ones that fly under the radar. Private hedge funds and private equity firms raise and invest money globally with little oversight in home or local markets and little allegiance to anything but profit. In addition, dozens of newly founded sovereign wealth funds (SWFs), semiautonomous investment pools, complicate this incredible web of money.

Media: While newspapers have been with us for centuries, the rise of television and the Internet as shapers of public opinion should not be underestimated. Information floods the airwaves and cyber streams of modern existence. Indeed, CNN, Fox News, Al-Jazeera, blogs, MySpace, and YouTube all have far more influence with more eyeballs watching than ever before. Some truly enlighten and some entertain, while some promote hate, fear, and insecurity.

Nongovernmental Organizations: In the past, nonprofit organizations such as the Red Cross, Oxfam, and Greenpeace seemed to only represent a limited set of humanitarian causes. Today, some NGOs have become important agents of cross-border socio-economic progress and hope. Grameen Bank, a pioneer in microlending, and the Gates Foundation, with its goal of solving global health problems, have proven to be far more effective in certain areas than multilateral organizations like the World Bank and the World Health Organization. Governments could probably learn a few lessons from these players.

Paramilitary Groups: War has traditionally been waged by governments. But one of the dual-edged swords of globalization is the rise of decentralized paramilitary groups including mercenaries, private military corporations like Blackwater and Titan, guerilla movements, warlords and subnational and cross-border terrorists like Al-Qaeda. And while all of these actors are not necessarily unjustified or wrong, they nonetheless dramatically complicate the global arena of defense and security.

All these NSAs add to the quantum web that is our world. And because their activities are so dispersed and complicated, they cannot be controlled in the classic sense. At a bare minimum, however, they need to be better understood to see how public policies can influence and harness them properly.

Working Toward the Capitalist Peace

Whether we are talking about rising emerging markets or nonstate actors, the peaceful integration of these important players rests upon the harmonization of old and new interests. While conventional wisdom draws upon the theory that democracies generally don't war with each other, there is a long "capitalist peace" tradition that includes many great historic thinkers like Charles de Montesquieu, Adam Smith, Norman Angell, and even Tom Friedman that would attribute our current Pax Americana to free trade and open markets. In 1846, British classical liberal statesman Richard Cobden described trade, which was just taking off as a result of the Industrial Revolution, "as the principle of gravitation in the universe, drawing men together, thrusting aside the antagonism of race, and creed, and language, and uniting us in the bonds of eternal peace."[14]

Open markets lessen incentives to war by changing the way societies produce wealth and increasing exchanges between states. For the better part of the sixteenth, seventeenth, and eighteenth centuries, under state-centered mercantilism, land and natural resources were the largest sources of wealth. With the advent of capitalism and the Industrial Revolution, wealth became linked to the production of goods instead. Capitalism requires property rights and free decisions by market participants to work. In the old days, seizing gold bullion may have made it yours, but now seizing a factory cannot make its assembly line workers work.

Under capitalism, war becomes a bad bet; the costs of destroying property, plant, equipment, and human capital—combined with out-of-pocket military costs—far outweigh the modest gains of territorial conquest. Moreover, capitalism and trade not only reduce incentives to fight, they also provide an alternative mechanism for countries to compete yet cooperate—and everyone goes home a winner. Countries with excess capital don't conquer those with a lot of labor; they increase immigration or outsource production overseas. Conversely, developing countries with skilled workers don't plunder their neighbors for money; they rely on global financial markets and foreign direct investment from capital-rich places, so long as they remain open, friendly, and respect the rule of law. Only in rare exceptions do trade-engaged nations now seize or nationalize foreign-owned plants, factories, or industries, because that unnerves foreign investors who will quickly cut off capital access.[15]

Rising affluence associated with capitalism, in turn, also makes war look like a bad deal. To echo Bob Dylan, when countries got something, they've got something to lose. In the postwar period, we've seen many countries grow wealthier. In 1950, only six countries in the world had

50 percent of U.S. per capita GDP; by 2006 that number was over 35 with probably a few more on a PPP basis.[16] Moreover, the number of countries with at least 25 percent of U.S. GDP per capita has grown from 20 to more than 50.[17] Much of this has to do with the abandonment of centrally planned economies for market-based philosophies and the build out of economic freedom, not necessarily the spread of U.S.-style democracy and universal suffrage.[18] In this respect, democracy probably has been overrated and capitalism underrated, as John Mueller has written.[19]

While it is true that capitalist countries tend to be democratic, economist Milton Friedman reminds us that "history suggests that capitalism is a necessary condition for political freedom,"[20] even in the absence of democracy, the inverse relationship between free markets and war holds. Empirical evidence also weighs in capitalist peace theory's favor. Like we'd expect, the world today is quite peaceful compared to a century ago. According to the *Human Security Report*, all forms of warfare—from interstate to even intrastate conflicts—have fallen precipitously in the postwar period.[21] The number of international and civil conflicts fell from more than 50 in 1990 to just over 30 in 2005 with the annual death toll from conflict falling from more than 200,000 to less than 20,000 in the same time frame.[22] Recent research from Erik Gartzke confirms that economic freedom has a high predictive value of whether a state will engage in war; in fact, his studies note that capitalism has proved to be a much stronger—actually 50 times stronger—correlate of peace than democracy.[23]

These are key lessons in the postwar period, and the United States' post-Cold War insistence on pushing democracy and human rights globally has likely made the world less safe by failing to focus on economic issues and the capitalist peace. Arguably, a wealthier world is more in humanity's best interest than a romanticized vision of homogenized self-governance. In this light, the neoconservatives' misplaced emphasis on democracy has been problematic or even counterproductive.

The Moment of Misperception

The rise of new players and the United States' failure to react begs the question, how long have the United States and the G7 misread the global tea leaves? The first sign of the G7-led world order's impending derailment came in 1997, with the G7's curiously mixed invitation to Russia to join as the eighth member. Even though its economy remained fragile, Russia—despite its dangerously large nuclear arsenal—was invited into the G7 but was barred from key discussions that coordinated global trade and interest rates, the group's *raison d'être.* The G7's refusal to aid Russia during its 1998 financial crisis underscored that country's second-class status in the fraternity. Would the United States have let Canada or the United Kingdom default on its obligations if a similar situation existed? Probably not. Instead of taking Russia into the flock and building a new ally, the G7 cast it out and made it a black sheep.

The treatment of Russia makes it seem like the G7 didn't believe its own multilateral rhetoric. High on Cold War victory euphoria, policy makers rested on their laurels. Except for a few unpopular humanitarian efforts under Bill Clinton in Mogadishu and Kosovo, foreign policy became an ad hoc extension of Cold War reflexes. As such, the G7 chose to engage Russia politically when Russia badly needed economic engagement. With oil prices hovering around $12 a barrel, no one thought Russia was terribly important. The G7 completely misunderstood the great economic convergence that was to begin in the late 1990s and what that would mean to global energy demand and Russia's future.

With oil above $30 a barrel for years—and now having peaked at $147—Russia has built a war chest of half a trillion dollars. In the first seven months of 2008 alone, Russian firms invested more than $4.2 billion in U.S. companies and assets as well as another $17.4 billion in companies outside of the U.S.[24] Even in spite of recent turmoil in its banking sector and falling commodity prices, Russia is a geopolitical force to be reckoned with. The country now regularly asserts itself in touchy cross-border debates (such as in Iraq, North Korea, and Iran) with little regard for American or G7 approval. Moscow exerts great pressure on its immediate neighbors, invading Georgia at whim, and often threatening Belarus and Ukraine. Russia's relationship with several European G7 members has grown tense given their addiction to Russian energy, complicated by disagreements on the eastward expansion of NATO with its proposed antiballistic missile defense system. Moreover, Venezuelan President Hugo Chávez and Russian President Dmitri Medvedev have declared plans to closely coordinate their actions on global oil and gas markets and foreign policy efforts. Even as late as October 2008, Russia was conspicuously absent from the G7's emergency discussions over the global credit crisis.

In addition to the misstep with Russia, the tragedy of 9/11 also exacerbated intra-G7 tensions. The attacks on New York and Washington, D.C., and the subsequent bombings in Madrid and London, created a weak, vulnerable mindset in the United States and Europe. Once bastions of security, many postwar powers looked prone in ways they could not have dreamed a decade earlier. This psyche of vulnerability has lead to unhealthy cross-border policy postures. Much of Europe seemed bewildered, tentative, paralyzed—perhaps understandable given the continent's historic monetary union, aging populations, stubborn unemployment, and sluggish economies. While Europe dealt with problems at home, the United States has turned aggressive, lashing out on the world scene. The controversial U.S.-led invasion of Iraq in 2003 marked Washington's ultimate stumble. The offensive has drained America of more than $1 trillion in direct costs (and another $10+ billion each month) and some estimate multiples of that amount in indirect costs, creating deficits financed by foreign creditors—including many emerging market central banks and sovereign wealth funds. Whether we like it or not, the United States now needs these foreign investments to close fiscal and trade gaps. The largely unilateral invasion, carried out without UN Security approval, and the subsequent occupation of Iraq have also created animosity between G7 members and alienated many rising countries. In turn, these countries quietly minded their own business, grabbing bigger slices of the world economic and financial pies. Although this began before Iraq, it has accelerated in the last few years.

The Iraqi invasion has promoted a hostile image of the United States as a paranoid unilateralist. Many outside the United States (and inside as well) view the Bush administration as dishonest. Popular Arab media portray the invasion as a ruthless oil grab, while many U.S. critics cite it similarly as a strategic oil diversification away from Saudi Arabia. The markets tell us that the United States' position is weakening, and the U.S. dollar—once a sign of the country's rock-solid strength and stability—is not nearly as valuable as it was a decade ago. Commodity markets have gyrated, stock markets imploded, housing bubbles have burst, and credit markets have frozen. Will the great trade success we have witnessed begin to reverse?

U.S. relations abroad are growing strained. In Europe, anger over Washington's policy in Iraq, Israel and Palestine, and even the handling of the credit crisis have caused strains. The United Kingdom still maintains the notion of a "special relationship," but public polls hint that this friendship is also waning. In the Americas, the rise of socialist, left-leaning governments and anti-U.S. sentiments in Bolivia, Ecuador, and Venezuela, leave the United States with fewer allies. Moreover, the U.S. congressional vote to build a 2,100-mile fence on the Mexican border certainly has not been embraced by our southern neighbor. In Asia, the United States' tenuous alliance with Pakistan in the War on Terror has not enthused India at a time when the United States would like to forge a closer relationship with the world's largest democracy. The North Korea nuclear escalation and the U.S. military's lost luster in South Korea has also rekindled Japanese rumblings over possible remilitarization, which spooks China and entangles three countries that have little historic love for each other. Are things falling apart? Can the center hold?

The New Financial Arena

Amid the global credit crisis, the United States and the G7's financial weaknesses are being exposed, to the detriment of markets worldwide. As we learned during the emerging market crises of the 1990s, everyone's policies now greatly affect one other. Yet the United Nations, the World Bank, and NATO are still dominated by white, Christian economies from North America and Western Europe that represent but a small minority of the planet. As a result of the dramatic recalibration of world power over the past two decades, U.S. and G7 global influence relative to that of other states is shrinking. Countries are sidestepping protocols and treaties, ignoring what suits them, and paying little mind to global civic responsibilities. Where are the United States and the G7 in this debate?

The G7, unfortunately, is bogged down in a struggle with its own demons. Critics question the lack of representation from the "global south," as well as the exclusion of China. In 2007, French President

Nicolas Sarkozy made a long overdue public statement recommending the expansion of the G7 to include China, India, Brazil, Mexico, and South Africa.[25] Others call for more Persian Gulf representation. If it cannot evolve, the G7 brand will be increasingly challenged in the coming years.

Not incorporating China may be the United States' biggest faux pas. China's rapidly growing economy has created a trade and investment codependency that many economists view as unhealthy. For years the United States has posted huge monthly trade deficits with China, which in turn, buys billions in U.S. Treasury bonds to help finance U.S. deficits. This unbalanced trade puts pressure on the Chinese to revalue their U.S. dollar-linked currency[26]—a discussion that would normally be within the domain of the G7; however, China is not a G7 member. China, of course, prefers a weak currency that keeps its exports flowing and its large population working. China's weak currency is beginning to irk the EU as well.

There are other important issues that strain U.S./G7 relations with China including human rights violations, intellectual and commercial piracy, and the country's murky long-term military ambitions. China's surprise ballistic missile launch in early 2007 to destroy an aging weather satellite promoted formal protests by the United States, Canada, and Australia, largely for not forewarning the world community. While the Chinese assert the test as a nonthreatening event, some U.S. critics view it as a demonstration of a significant military capability. At the same time, there are fears over Chinese companies' increased investments overseas as well as Chinese sovereign wealth funds taking strategic positions in U.S. and European corporations. All told, this is a relationship that has not been well cultivated in recent years, which is unfortunate given China's immense economic momentum and influence.

According to the International Monetary Fund, the leading 20 emerging market economies have seen their hard currency reserves swell from approximately $500 billion in 1996 to more than $3.5 trillion in mid-2008.[27] During this same period, the E7 and Russia alone saw their reserves jump from $255 billion to $2.5 trillion. Places like Hong Kong have become financial rivals for the United States for capital surpassing it in initial public offerings, while banks from China are able to borrow more cheaply than the United States' blue-blooded J.P. Morgan. Even Las Vegas has been displaced by Macau as the world's leading gambling center.

To emphasize the point, take a look at the recent fallout from the credit crisis with European and U.S. banks needing not only home country bailouts, but foreign investments totaling more than $100 billion from governments in Asia and the Middle East to bolster their capital bases from subprime losses. Imagine that: Some of the largest, mightiest U.S. and European banking groups had to borrow from countries among the world's poorest just a generation ago. Whereas the 20 most valuable financial groups in 1988 were American, Japanese, and European, by 2008, many were Chinese, Indian, Brazilian, and Russian. The world, indeed, has changed dramatically.

A major factor of this change is global capital flows. According to the International Monetary Fund, cross-border capital flows tripled in a 10-year period, reaching $6.4 trillion—roughly 15 percent of world GDP—by 2005.[28] Moreover, money flows are rapidly changing in origin, direction, and character. The remarkable growth of financial markets outside of developed economies since the bursting of the U.S. technology stock bubble in 2001 is notable for its diversity—stretching from East Asia through the Middle East and Eastern Europe to Latin America. The Mexican peso crisis of 1994, the East Asian financial crisis of 1997, and the Russian sovereign debt default in 1998 increasingly look like bumps in the road rather than the ominous end points these events seemed as they unfolded. Notably the latest credit crisis and bank failures are taking place in developed—not emerging— countries. As Figure 1.2 illustrates, a list of the world's largest economies will dramatically shift by 2050. China and the United States will move to the top two with India as the third, but look at the remaining countries. We will have some from Africa, more from the Far East, including some countries today that are barely on the United States' radar screen.

With newfound success, many emerging markets have created sovereign wealth funds outside their central banks to accelerate global financial and economic integration. SWFs are state-owned entities that manage portions of national savings. Today, many of these funds are flush with trillions of dollars due to record-high oil and natural resource prices.[29] As long as prices for energy and other commodities

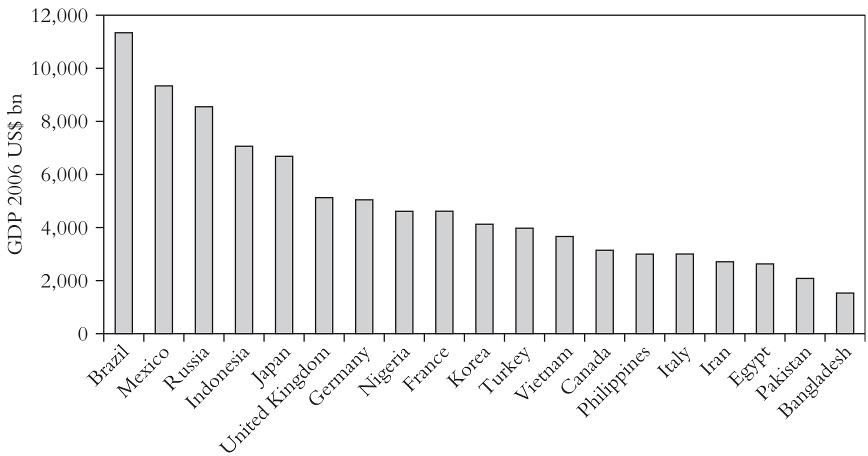

Figure 1.2 The World in 2050 (ex-China, United States, and India)
SOURCE: Goldman Sachs.

stay high, this trend will persist. And because the United States and the G7 have less experience in dealing with these new players, the motivations of SWFs have become the subject of endless speculation. Calls for greater transparency and disclosure by the Western media and government officials occur daily, underscoring the nervousness over these powerful entities.

Whether or not G7 countries better integrate with emerging markets, the newcomers are now directly investing in each other's markets. Foreign direct investment (FDI) between emerging markets has increased significantly in recent years, reaching approximately $220 billion in 2006, double from just 10 years earlier.[30] Developing countries attracted about 36 percent of global FDI in 2006, and while it is commonly assumed that these investment flows originate in the developed world, there has been a surge in FDI from emerging markets.[31] According to the World Bank, FDI between developing countries increased from about $14 billion in 1995 to $55 billion in 2006, indicating intensifying commercial and financial activity that is now completely outside the G7's purview.[32]

A striking surge in intra–emerging market investment flows can be seen between China and Africa. In large oil-exporting countries like Angola and Nigeria, China is building railroads; in mineral-rich countries like the Democratic Republic of Congo, Chinese companies are active in mining cobalt, copper, and bauxite. China is investing in agricultural countries like Cote d'Ivoire, building a new capital in Yamoussoukro financed by Chinese loans.[33] All across Africa generous Chinese aid packages and low-cost loans with few strings attached have made World Bank loans seem paltry and cumbersome. The World Bank and International Monetary Fund have voiced concerns that China's unrestricted lending, including a $2 billion credit line for corruption-plagued Angola, has undermined years of painstaking efforts to arrange conditional debt relief. The World Bank is also upset at lending by Chinese banks that do not follow Equator Principles, project-financing standards that emphasize certain social and environmental goals.[34] But the Chinese view all this differently. "The Western approach of imposing its values and political system on other countries is not acceptable to China," said Wang Hongyi, of the China Institute of International Studies.[35] Critics say Chinese efforts not only give their companies an edge in the competition for resources, but also that it will give China's diplomats an advantage at the United Nations and other international organizations, where African countries can constitute a powerful voting bloc.

This China cash diplomacy has also spilled into war-torn Sri Lanka where Chinese assistance has grown to nearly $1 billion, pushing it past Sri Lanka's longtime largest donor, Japan. The Chinese are building highways, developing two power plants and putting up a new port in the hometown of the Sri Lankan president. In turn, the Sri Lankan government buys weapons from China for its ongoing conflict with the Tamil Tigers,[36] allowing it to bypass Western human rights concerns.[37]

Perhaps the greatest criticism has been China's recent relationship with Sudan. Since 2003, more than 200,000 people have been killed and some 2.5 million made homeless in Sudan. During this period, China has largely ignored the atrocities in Darfur, purportedly strengthening its political, economic, and military relationship with the government of Sudan through long-term energy contracts. China is currently the largest known provider of small arms and ammunition that have been used by agents of the Sudanese government to wreak havoc in Darfur, although the Chinese government has publicly denied any wrongdoing.[38]

Moreover, Gerhardt Schroeder, the former chancellor of Germany, spoke of an impending "China-Russia combination," a relationship that would truly weaken G7 relationships with Asia. Schroeder supports the strengthening of the EU-Russia relationship, and is critical of the United States "containment policy" toward Russia, which he believes will only deepen the gap between energy policy and trade initiatives.[39] It is now only a matter of time: Russian President Dmitry Medvedev has called on Russian business to follow China's lead and invest in companies abroad in order to aggressively pursue global assets and foreign technology, as well as suggesting Russia dumps the U.S. dollar as a reserve currency.

Backlash: Where Is Globalization Taking Us?

Never in the postwar period have so many countries' economic and political policies affected the global economy and capital markets as they are today. On the surface, this development seems healthy. But trouble is brewing. In the last few years, a variety of crises—including financial meltdowns, food shortages, civil wars, terrorism, environmental stress, energy insecurities, and the formation of new security blocs—have arisen with the potential to cripple economic growth and frustrate flows of money, goods, and people. These looming worries stoke of a reversion to protectionism, capital controls, and other regressive, inward-oriented policies. Such warnings along these lines came from historians such as Niall Ferguson and Harold James, Nobel Laureate economists such as Joseph Stiglitz, and even mega-investors like George Soros, long before credit crisis began.

One sign of the looming trouble is the U.S. dollar's troubled swings. The U.S. dollar's hegemony is clearly under attack. The U.S. economy has outstripped almost all of its competitors for much of the past century and enjoyed monetary privileges due to its market power. But now, most countries whose currencies were once pegged to the dollar have made the difficult break and now float freely. Those that did not, like some countries in the Gulf region, are now in talks to do so, or have begun to use a basket of currencies rather than the dollar alone. Weak countries that pegged themselves to the U.S. dollar in recent years have suffered deeply, unable to bear the dollar's depreciation with their weak central banks and fickle fiscal policies. Currently, many of the world's central banks are holding more dollars than they really want or need—though not often out of loyalty to the United States. East Asian countries, especially, bought U.S. public sector debt in order to keep the dollar from depreciating relative to their own currencies and to maintain the levels of U.S. imports necessary to sustain their export-driven economies. If they were to dump the dollar it would surely create panics and reverberations not seen since the last Great Depression. While the flight to quality in late 2008 has stymied the decline in the dollar's value, in the long run, its value remains questionable.

Many commentators draw parallels to the pre-World War I period of economic integration that bloomed from 1880 to 1914. That globalization era—once assumed to be irreversible—was ultimately obliterated by 30 years of world war and depression. Do we face such risks today? Are we less secure in our cross-border relationships than we believe? Can the United States, once unquestionably the leader of the free world, speak for the entire planet in the twenty-first century? Should it try? And are we—citizens, businesspeople, and politicians—even aware of this historic opportunity and the diminishing time frame for action?

While most people around the world feel that the globalizing economy has been beneficial, antiglobalization sentiments are rising, and may intensify with the fallout from the credit crisis. Such concerns are strongest in the richest nations, while Africans have the most positive attitudes toward globalization. In a recent *Financial Times*/Harris Poll, citizens in Britain, France, the United States, and Spain were about three times more likely to say globalization was having a negative rather than a positive effect on their countries.[40]

These fears give rise to policies of protectionism. The largest European economies are especially prone because of their combination of weak growth, aging populations, high unemployment, and fear of job losses to lower-wage countries in Eastern Europe and Asia. This can also be seen in the resistance to EU expansion. In much of Europe, there is strong public opposition to Turkey joining the EU. In 2005, Angela Merkel and Nicolas Sarkozy, who oppose Turkish accession, came to power in Germany and France, respectively, giving elite support to widespread public sentiment.

Alongside protectionism, nationalism has also returned. In the more developed European states such as France, Austria, the Netherlands it is often expressed in anti-immigrant or ethnic- and language-oriented policies. In some new EU member states a potentially more dangerous form of nativism has emerged. In Poland, Hungary, and Romania, for example, nationalist, anti-Semitic, and anti-Western political messages have become commonplace.[41] The EU accession process stifled some of these impulses, as these countries understood the need to adhere broadly to the secular democratic values of the core EU states. But once these countries have gained EU admission, that constraint becomes less binding.

Across the Western world, political constituencies that favor tougher limits on immigration are gaining support despite evidence that increased restrictions on immigration will hamper the supply of skilled workers and raise costs. Fringe political groups have been successful in creating messages built around opposition to immigration. In many European countries, mainstream parties are finding it difficult to assemble governing majorities. As a result, they take strange bedfellows, embracing supporters who are sympathetic to the anti-immigration message of the fringe who encourage mainstream politicians to push for more restrictive immigration legislation.[42] At the same time, the European Commission forecasts that the EU needs to open the door to an extra 20 million workers, particularly highly skilled workers, over the next two decades to fill the gaps in the workforce.[43] Several European countries remain torn between the economic case for more immigration and an attachment to the traditional idea of a homogeneous nation-state.

Protectionist measures invite a spiral of retaliation. The impact on economic growth of a rise in protectionism could be severe. The Economist Intelligence Unit forecasts that even a relatively modest backlash against globalization could shave nearly a full percentage point off annual world GDP growth during the period 2011–2020.[44] Meanwhile, trade protectionist pressures are rising. In the United States, the president's Trade Promotion Authority (TPA) expired in July 2007. TPA is a procedural device that gives the White House power to negotiate trade deals and then present the final product to Congress for an up-or-down vote with no amendments. It is considered critical to the U.S. free trade agenda because trading partners are reluctant to engage in trade talks when they know that the U.S. Congress could potentially alter the terms of the completed deal afterward.[45]

Political turmoil in Europe over EU enlargement and foreign competition, pressed by aggressive hard-right factions in member states, may fracture Europe's ongoing economic and political integration and cause the continent's hard-won consensus on trade policy to unravel. Given the EU's stature as a pillar of the global trading system and its close relationship with the United States, its dissonance on trade would provide cover for other countries to adjust their own trade policies away from multilateralism.[46]

Emerging market countries also face growing opposition to globalization, especially trade liberalization. Responding to domestic constituencies, Brazil has imposed tight capital controls and high import tariffs that are particularly disruptive to U.S. business interests.[47] Brazil's perspective resonates with other South American countries, and it will increasingly become a leader in a growing bloc of harder-line developing countries that has already helped to delay the Doha Round of WTO negotiations.

As emerging market countries, Russia, India, and China among them, have grown in economic and political power they have intensified their regulatory scrutiny of cross-border FDI and merger and acquisition activity based on political and national security grounds. Regardless of the pretext, these measures are often intended to shield uncompetitive domestic industries and firms and drive global prices higher for lucrative natural resources. These pressures are causing governments to consider a variety of measures to tighten assessment of FDI flows, including introducing legislation fencing off "strategic sectors," such as defense industries and critical infrastructure, to potential foreign acquirers.[48]

Although it is deemed too important to fail, progress on concluding the WTO's global trade talks has been unfortunately slow. Launched in November 2001, Doha aimed to further liberalize global trade by cutting industrial and agricultural tariffs and by reducing farm subsidies, emphasizing benefits for developing countries. A conclusion to the talks has proved elusive, with the EU and the United States in particular being accused of failing to reduce farm support while such emerging market countries as Brazil and India have refused to open their markets to industrial goods and services. While majorities of developing countries around the world believe international trade benefits their national economies and corporations, many people, particularly in G7 countries, feel that free trade threatens jobs, lowers worker protections, and harms the environment.[49]

In place of the slow-moving global talks, trading nations are pursuing Bilateral Trade Agreements (BTAs) as more expedient alternatives. There are about 300 BTAs in force in 2007 worldwide and the number is growing, covering about half of the global trade volume. China is especially efficient in using BTAs as a strategic foreign policy tool to gain access to natural resources and develop new alliances in Africa and Latin America. The United States is also employing BTAs but on a much smaller scale given congressional protectionist sentiment and outright resistance as well as demands for additional labor, environmental, and enforcement safeguards. Ultimately, the proliferation of BTAs and the stagnation of Doha raise the prospect of weakening the multilateral system that has governed global commerce for the past six decades, possibly leading to a splintering of the global trading system into regional blocs. Another potential development is an erosion of respect for the WTO's authority to settle disputes, increasing the chances that countries will resort to tit-for-tat trade wars that could disrupt the global economy.[50]

The extended delay of the Doha Round is a sign of this new period of uncertainty. Not too long ago, Bush administration officials spoke optimistically about a free trade zone "from Alaska to Tierra del Fuego," and a world free of industrial tariffs by 2015. Today, that vision looks unlikely. It is up to Washington to consolidate what clout it has left, and be generous toward rising powers, engaging these nations in formulating new multilateral, international policies that tackle the global challenges of energy, environment, health, and security.

Converging or Diverging Interests?

The rise of emerging markets has come so quickly, and the potential for their influence is so huge, that today we need to consider them not only as economic opportunities but also as cooperators and partners in managing the global risks of the twenty-first century. However, the G7 and these new emerging powers have diverging perspectives on trade, human rights, the environment, and energy that have stymied progress in multilateral forums like the World Bank, the WTO, and the UN, where rising powers are relatively underrepresented. Can these nations continue using the global economic system, its capital markets, its stability, and laws without paying the dues owed to keep the system intact? Yet how can these players be asked to act more responsibly without adequate representation in global governance forums? This is the global chicken versus the egg conundrum.

Without insitutional reform, many of these developing countries—as well as some G7 nations—may continue to free ride and circumvent international norms, and some may even evolve into fierce, cutthroat competitors, rendering the United States less relevant globally. And, lest we forget, increased competition inevitably will strain internal G7 relations as diverging interests grow. The tense relationship with its eighth member, Russia, on everything from energy policy, nuclear proliferation, democracy, and human rights to the future of NATO potentially could undermine global stability. And the United States is tangled up in all of these webs. The real question of the moment is: Will America wake up and see the elephant?

Toward a Quantum Framework for the New Millennium

For much of this millennium, the United States has relied on familiar linear, unilateral problem-solving approaches—a "Micro Domestic" paradigm. This atavistic bias makes U.S. policy increasingly ill suited for today. President Bush's foreign policy, for example, could be a page stolen from Ronald Reagan's early 1980s playbook. His "war on terror" is akin to the "war against communism," with the "axis of evil" supplanting the "evil empire." The great reliance on increased military spending is reminiscent of Reagan, with our economy increasingly exhibiting the twin deficits that developed under that administration. Beyond defense, U.S. postures and policies on energy and fossil fuel use, agriculture, and the environment also seem woefully out of step with twenty-first century realities.

While the Micro Domestic approach may have worked well enough in a bipolar world, it demands serious reappraisal today. We live in what physicists might call a "quantum" world, one of infinite connections. As we've outlined, there are now many, not only one or two, power brokers. Additionally, the scale of global interaction that occurs today is dizzying compared to 100 years ago or even 20 years ago. The amount of information, goods, money, and people that now cross borders, and the velocity of these movements, has permanently altered the international landscape.

To prosper in this new environment, we need a new approach—what I call a "Macro Quantum" paradigm—that can better cope with more players, greater interconnectivity, and less predictability. Just as a modern medical doctor wouldn't operate on a heart without monitoring the brain and lungs; similarly, we must not operate in world without thinking of the ramifications to Beijing, London, and Brasilia, as well as to the earth itself. In simple terms, we must see the entire elephant not just individual parts.

Whereas a Micro Domestic paradigm relies on past strategies, the Macro Quantum perspective is forward thinking, understanding that new ways are needed for further progress. A Macro Quantum perspective assumes cross-border relations are unpredictable not fixed. Importantly, the Macro Quantum paradigm acknowledges that there are many ways forward, and the right choice depends on situational context as opposed to one correct approach. While some Americans may pine for the sense of moral clarity of an us-versus-them world, we must readjust our thinking to realize there are no right or wrong solutions anymore, just better or worse. And lately the latter have won out. For example, American-style democracy may work for us, but that doesn't mean imposing a constitution and a bicameral parliament on every nation will create functional government, let alone a prosperous country. The highly differentiated states of the Macro Quantum world, each with unique traditions and histories, demand custom-made solutions not one-size-fits-all.

Whereas under the Micro Domestic approach, the United States aimed to *control* countries and events, in the Macro Quantum world we endeavor to build partnerships to *influence* and help *manage* trends. During the Cold War, the United States never had to question the allegiance of its NATO allies. In addition to the looming threat of the Soviet Union, the United States used its massive economy and military might to push allies to accept its decisions. In the new millennium, this is no longer the case: The United States' attack on Iraq bothered some of its closest allies and caused significant discomfort in many European capitals. Learning to play nice with other countries will be a tough but ultimately rewarding lesson for the United States in the new millennium.

Beyond working with more countries, understanding and constructively managing relationships with nonstate actors will also be a valuable survival skill. Instead of eyeing newcomers with caution and suspicion, we must acknowledge their potentially useful roles and set clear rules that will allow these players to function in a transparent and helpful way. In the case of terrorists and paramilitaries, devising new strategies to neutralize their influence over the global rule-based system of interaction will be invaluable.

Finally, in the Macro Quantum world, policy-making must be a proactive, constant process, involving many actors, both sovereign and civilian. Whereas a Micro Domestic stance views policy issues as separate and distinct from each other, Macro Quantum strives to foster integrative policies that kill many birds with a few stones. Moreover, domestic policies must be adaptive and synchronized to global phenomena rather than unilateral. Table 1.4 compares my Micro Domestic and Macro Quantum paradigms.

With this philosophical shift, the United States and its allies can begin to examine seven large, interlinking areas that will demand serious attention in the coming years, and which will consequently be the subjects of the chapters in this book (also see Table 1.5).[51]

1. **Trade and Finance:** For decades, global trade volume has been growing twice as fast as world output and is the basis for greater cross-border interaction and wealth creation. But the recent collapse of the Doha trade talks underscores acute policy divides that exist and the rise of bilateralism. The G7 members subsidize agriculture by more than $300 billion annually, and key developing markets now retaliate with tariff protections in many manufacturing and high-tech sectors. Without breaking the multilateral logjam, the goal of poverty eradication by trade engagement—the world's most successful model—may never be achieved.

Table 1.4 Micro Domestic vs. Macro Quantum Paradigm

Micro Domestic	**Macro Quantum**
A present, or worse—a historic—time bias.	A forward time bias.
Assumes a larger degree of certainty and predictability in cross-border relations.	Assumes a larger degree of uncertainty, ambiguity, and unpredictability in cross-border relations.
There is only one best way, often from a domestic or small group perspective.	There are many ways forward depending on many global moving parts.
A primary emphasis on control with concentrated power among a few allies.	An emphasis on influence derived from positive behavior distributed widely among a broader range of players.
Countries are viewed cautiously, as competitors with disparate interests; little focus on nonstate actors.	Countries, working with nonstate actors, are cocreative partners with common interests.
Policy change is reactive, initiated by the hegemon.	Policy change is proactive, constant, involving many actors, sovereign and civilian.
View policy issues as separate, compartmentalized, and domestic.	View policy issues as interrelated, integrative, and global.

With more trade and capital flowing than ever before, the need for coordination is greater than ever. Whether the World Bank is currently configured to shepherd this transition is debatable. The surprising flip of E7 debtors to creditors of the G7 in the last decade muddies the World Bank's original objectives. Other global accords, such as Basel II, need to be revaluated for their usefulness in a rapidly globalizing world. Indeed, the global scope of the credit crisis underscores the need for multilateral coordination in the financial markets.

Moreover, financial imbalances due to government and trade deficits, demographic immigration patterns, and flawed energy policies, among others, need to be addressed within the context of long-term trade and investment ramifications. In the United States consumption-led policies (including excess borrowing) may need to be altered toward savings, and the entire focus on GDP expansion

Table 1.5 The Seven Policy Areas under the Micro Domestic and Macro Quantum Paradigms

Global Issue	Links	Micro Domestic	Macro Quantum
Trade & Finance	Energy, Security, Immigration, Health, Environment, Poverty	Rearward, domestic perspective; subsidies for old industries; trade-stunting policies; fossil fuel orientation; hostile to foreigners; highly leveraged, consumption-focus; little value on environment; little interest in low GDP countries; focus on domestic GDP at any cost.	Forward, external perspective; subsidies for future viable industries; trade-enhancing policies; diversified energy approach; encouraging foreign participation; less leveraged, investment-focus; greater value on environment; greater interest in low GDP countries; focus on well-being beyond traditional yardsticks.
Energy	Trade, Security, Immigration, Health, Environment, Poverty	Heavy dependence on imports for oil, reliance on coal for electricity, few public incentives for renewables.	Less reliance on imported oil; diversified approach to electricity; more public incentives for renewables, with focus on solar.
Security & Defense	Energy, Security, Immigration, Health, Environment, Poverty	Nuclear deterrence; NATO forces; containment strategies; majority underwriter of global defense; defense geared toward low probability scenarios; peace through strength; physical U.S. armed presence overseas; protecting oil access; arms sales.	Nonproliferation; wider NATO membership; flexible, rapid response strategies; smaller underwriter of global defense; defense geared toward higher probability scenarios; peace through cooperation; reduced physical U.S. armed presence overseas; greater UN peacekeeping efforts; reducing U.S. oil access commitments; limited arms sales.

(Continued)

Table 1.5 (*Continued*)

Global Issue	Links	Micro Domestic	Macro Quantum
Immigration	Trade, Security, Health, Environment, Poverty	Zero-sum perspective, protectionist orientation, lesser skilled focus, prohibitive legal framework since 9/11, viewed as a one-way street.	Opportunity to attract needed labor, stemming tide of outsourcing; higher skill focus; strategic immigration as economic tool; viewed as a two-way street.
Health	Trade, Security, Immigration, Health, Environment, Poverty	Domestic focus, emphasizes curative solutions.	International focus, emphasizes preventative policy.
Environment	Trade, Energy, Security, Immigration, Health, Environment, Poverty	No major domestic or global policies, overreliance on fossil fuels, misdirected subsidies, no global accords.	Greater global oversight of environmental standards; commitment to renewable energy; push for global accords on several stress points, especially agriculture.
Poverty	Trade, Energy, Security, Immigration, Health, Environment	Limited foreign aid channeled through multilaterals, sporadic commitments to foreign governments through the UN and World Bank.	Increased foreign aid channeled through NGOs, micro lenders, and BOP strategies with MNCs; longer term commitments with new social entrepreneurial organizations.

at any cost also requires serious refinement. Progress in the twenty-first century quantum world cannot be measured by GDP alone, and may require alternative indicators to guide policies.

2. **Energy:** With expanding economies and wealth comes greater demand for power. Few countries are energy independent, and most are addicted to fossil fuel for transport and electricity. The concerns over global warming and the waning availability of

hydrocarbons will continue to polarize rich and developing countries, exacerbating tensions with the G7, unless common environmental and energy policy solutions are found.

New demand for energy has also generated unprecedented hard currency flows to Russia and other oil exporting nations over a very short period. To guard against further concentrations and imbalances, greater cooperation toward efficient energy usage and in spurring renewable and domestic power production needs urgent encouragement. Promotion of nuclear energy, too, calls out for global coordination as it holds the potential for weapons conversion.

3. **Security:** While overall cross-border warfare has declined with greater trade integration, there remain major security threats that all countries need to consider. Nuclear proliferation is a universal issue, regardless of domestic agendas. Moreover, all military conflicts—conventional or guerilla, cross-border or domestic—threaten the global system by draining resources and damaging productive capabilities. And while weapons of mass destruction grab the headlines, a more deadly threat are simple conventional weapons. The United States' 2009 military budget of $700 billion—more than the military expenditures of the next 10 nations combined—represents resources that could be deployed elsewhere more productively.

   One cost of membership in any expanded club of nations is greater responsibility for security. Broader global defense coordination should involve greater roles for other G7 members, as well as new rising powers, to deal with the more fragmented security issues the world collectively faces today. In building a greater collective capitalist peace, many new security strategies need to be reconsidered including an expanded, reconfigured NATO, greater global commitments to UN security and peacekeeping forces, greater global networks of local intelligence and law enforcement, a nuclear glidedown and bans on weapon sales, among others.
4. **Immigration:** The free flow of people has benefited the world, providing wealthier countries with fresh labor amid declining birth rates. In turn, developing countries see the gains of this labor export in the form of remittances. But immigration is a volatile issue across the globe that influences trade competitiveness and poverty and ignites protectionist sentiments. Understanding the

importance of freer movement of people could slow demographic trends in aging countries and promote freer movement of trade and help eradicate poverty over time. This would be a very different approach to immigration in wealthy economies, which have grown very protectionist in the last decade. Discouraging immigration increases the chances for outsourcing, which has also come under attack in wealthy countries. Finally, helping generate greater economic opportunity in developing countries may be seen as part of the global immigration solution, because most migrants are generally seeking better economic alternatives.

5. **Health and Drugs:** Whether HIV/AIDS, Avian flu, SARS-style outbreaks, or tainted food and medicine exports, health issues are no longer confined to one country's borders. Increased global interaction poses potential future health risks the magnitude and scale of which may be hard to comprehend. We forget that better health is a prerequisite for participating in the global economy. Seemingly simple programs in poor countries to raise daily caloric intake, alleviate childhood disease, and prevent infectious diseases like malaria, actually have great positive benefits that reverberate throughout entire societies. Health issues also will be a major concern for rich countries, as wealth gives rise to life-style-linked illnesses that cost societies billions in unnecessary, curative spending.
6. **Environment:** Setting aside the red-hot issue of global warming, there are a number of immediate concerns related to the environmental stress caused by G7 and emerging markets' economic activity. Shortages of energy, food, and water will reverberate globally if longer-term plans are not devised. One reason that the Kyoto Accord has stalled is the failure of both G7 and E7 members to acknowledge each other's environmental abuses, something an expanded working group might seriously address. But this rift cannot be addressed bilaterally, and action surely must be taken immediately if the world is to begin to turn the tide against the devastating consequences of global climate change. This clearly ties into energy usage, but the general environmental stress of greater demands across many areas outside of energy have spurred domestic and cross-border conflicts. One can only imagine the financial, security, and social ramifications of melting Arctic glaciers and ice

sheets in Greenland, events that could raise sea levels 40 or 50 feet, imperiling hundreds of millions of wealthy and poor populations that live on coasts around the world.

7. **Poverty:** More than two billion people globally still live on the margin of sustainability, something easy to forget amid globalization's broad gains. But for each new member of the middle class in China and India there are several impoverished and embattled in those countries as well as many in other parts of the developing world. Beyond the obvious moral implications, both G7 and emerging nations need to appreciate the demoralizing political frustrations that poverty creates around the world—and the security risks it foments. Moreover, the G7 needs to understand the pressures many E7 countries face internally given the massive economic gaps that have accompanied rapid industrialization and development, and rethink foreign aid and economic and financial engagement. Both the E7 and G7 need to begin to promote poverty eradication and more global economic opportunities beyond their borders. Most of the world's civil wars occur in relatively poor places and can spill across borders very easily.

America's Latest Challenge and New Global Agenda

After a disappointing start to the twenty-first century, President Obama will have a unique—and frustratingly short—window of opportunity to reassert American leadership and influence in global affairs. It will not be easy. Our leaders need to understand that what appears to be divergent interests among the G7 nations and rising powers are only superficial and that greater gains can be won for all if we are prepared to make bold and unorthodox choices with a Macro Quantum perspective.

It is today's great paradox: Countries are clearly moving closer economically, increasingly depending upon each other for commodities, trade, and capital, but they are unfortunately moving farther apart politically. In the past, forums like the G7 have helped forge multilateral working relationships—rules, behavioral codes, and mechanisms for collective progress and orderly conflict resolution. But, even if we are to ignore the signs of diverging interests and opinions among the current members, the very composition of G7 is surely less relevant today and no longer adequately represents the global system's expanded roster. The economic and demographic engines that have driven this new, unprecedented wave of globalization show no signs of slowing, and there is pressing need for multilateral, holistic coordination among old and new powers. The challenges are many, and as the world's waning but still strong hegemon, the responsibility of influencing the future rests with the United States, first and foremost. Although the United States has lost some global goodwill, it still has unmatched human and economic capital. But it is up to us to set the ball in motion. We must engage old allies, emerging markets, rising powers, and nonstate actors.

With fresh, comprehensive approaches across a broad spectrum of policy areas, the United States can reassert itself with an overarching, somewhat ironic goal: *to lead the world into an era no longer dominated by the United States.* In doing so, the country actually will be promoting its own self-interests by promoting collective interests. By shepherding new approaches and new institutions and by better understanding the interlinkages of global issues, the United States can increase chances for a bright future by winning the influence and leadership role with the global community it has seemingly lost.

Global Convergence and Sports

Standing 7-ft. 5-in., Yao Ming is one of the world's most recognizable athletes as the Houston Rockets starting center in the National Basketball Association (NBA). Ming is a poster boy for Apple, Nike, and Visa, and has received the most fan-generated ballots in several all-star games due in part to Chinese citizens voting in astonishing numbers. But more important, Ming is one among many foreign-born twenty-first century sports icons to make his name on the world scene. This is a major break from the recent past and provides a snapshot into global economic convergence and where the Macro Quantum world is heading.

Historically, professional sports have been dominated by the United States. But with increased globalization and wealth creation, upgraded overseas training has produced more competitive athletes for more sports from more countries than ever before. Professional basketball was one of the first U.S.-dominated sports to embrace the trend. In 1970, the NBA drafted its first two foreigners (neither made the league). Today, almost every team has at least one international player, and the league hosts approximately 100 overseas players (out of 450) from nearly 40 countries. With standouts like Ming, the NBA routinely scours the globe for stars such as Dirk Nowitzki from Germany, Dikembe Mutombo and DJ Mbenga from the Congo, Manu Ginobili from Argentina, and Peja Stojakovic from Serbia. Drafting talent internationally has become commonplace; now 50 percent of NBA-drafted players now come from abroad.

The globalization of sports goes beyond basketball. Take hockey, a popular international sport historically professionally dominated by Canadians and Americans. In 1970, 90 percent of NHL players were from the United States and Canada; by 2008, that number was down to 60 percent. Some of the game's best players in recent years have come from Eastern Europe, including Russians Alex Ovechkin—the world's highest paid player—Alexei Yashin, Sergei Federov, and Alexei Kovalev, and Czech star Jaromir Jagr.

In Major League Baseball (MLB), Japan has been producing talent in the last two decades including new sensation Daisuke Matsuzaka, former batting champion Ichiro Suzuki, and Yankee outfielder Hideki Matsui, while Latinos like David Ortiz and Albert Pujols comprise nearly 30 percent of MLB's players rosters.

In ladies' professional golf, South Korea fielded five of the world's top 15 ranked players in mid-2008. In fact, only 30 percent

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of the top 50 ladies players today are Americans compared to more than 60 percent in 1990.

In professional tennis, only two each in of both the top 10 ranked men and women hailed from the United States in 2008, with many former Soviet Union and Central Europeans dominating.

And the former Soviets also have toppled boxing, dominated by American men for much of the twentieth century. Brothers Vitali and Wladimir Klitschko of Ukraine and Uzbek Ruslan Chagaev have been boxing champions for most of the new millennium, with many younger Russians and Kazakhs also highly ranked.

And soccer, perhaps the world's most popular sport, has also seen a similar internationalization of talent. Twenty years ago, virtually all the players in the United Kingdom's famed Premier League were born in the British Isles. But take a look at the country's Chelsea (owned by Russian billionaire Ivan Abromovich) or Arsenal team rosters today. On Arsenal, only two out of 32 players were born in England (and they are rookies who rarely play). The rest of the squad comes from Brazil, Mexico, Togo, Ivory Coast, Switzerland, France, Spain, and Germany. Similar international rosters dominate Europe's Champions League. And these leagues increasingly have a global fan base. Many team web sites use multiple languages; Manchester United's site actually has versions in Chinese, Japanese, and Korean.

The internationalization of sports talent can also be seen more broadly in the Olympics. For the past five summer games through Athens in 2004, the concentration of gold medal winning countries has shifted dramatically. In 1988, 63 percent of the gold medals won were from just five countries; by 2004 it dropped to 41 percent. Moreover, in 1988 only 31 countries won the gold, jumping to 57 by 2004. While the Cold

War's splintering of the former Soviet Union explains part of this phenomenon, only seven nations that won gold medals in 2004 were newly created countries. But the greatest—and perhaps least surprising—Olympic rise is China, the world's largest country by population and one of the fastest growing economy for nearly two decades. In 1976, China failed to win one medal—not even a bronze—at the Montreal summer games. In 2008 in Beijing, America captured 36 gold medals (110 medals over all), but was surpassed by China's 51 gold medals (100 medals over all).

This global convergence of athletic talent, like global economic convergence, will continue. Poorer countries, for decades short on funds for sports, now have the disposable income needed to invest in and develop athletes. In fact, economics has a lot to do with Olympic medal winning outcomes. In a recent study, Andrew Bernard and Meghan R. Busse examined summer Olympic medal counts for the past 40 years to see what factors determine how many medals each nation wins. Statistically, just two factors account for 95 percent of a nation's predicted medal count: the number of medals it won at a previous Olympics and the overall size of its economy, bigger being better.

Per-capita income, oddly, is irrelevant. A large, poor country will win as many medals as a small, wealthy country, assuming they have the same overall gross national product (GNP). Of still greater importance than GNP is a winning Olympic legacy. Bernard has noted, if you have done well in the past, that's going to persist. "Once you develop infrastructure and training and facilities, and once you develop athletes, they do last for a couple of Olympics," he said.*

As more countries grow wealthier with economic globalization, this will continue. With more world-class facilities and training programs globally, we can expect to see more

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countries on the Olympic medal platforms over time as well as more participating and dominating professional sports in the near future. This will be no different in business, as many emerging market countries now produce talented individuals and companies to rival the United States' and Europe's former dominant positions.

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*Alex Berenson, "We Know the Winners. Now, Let the Games Begin," the *New York Times*, September, 10, 2000.