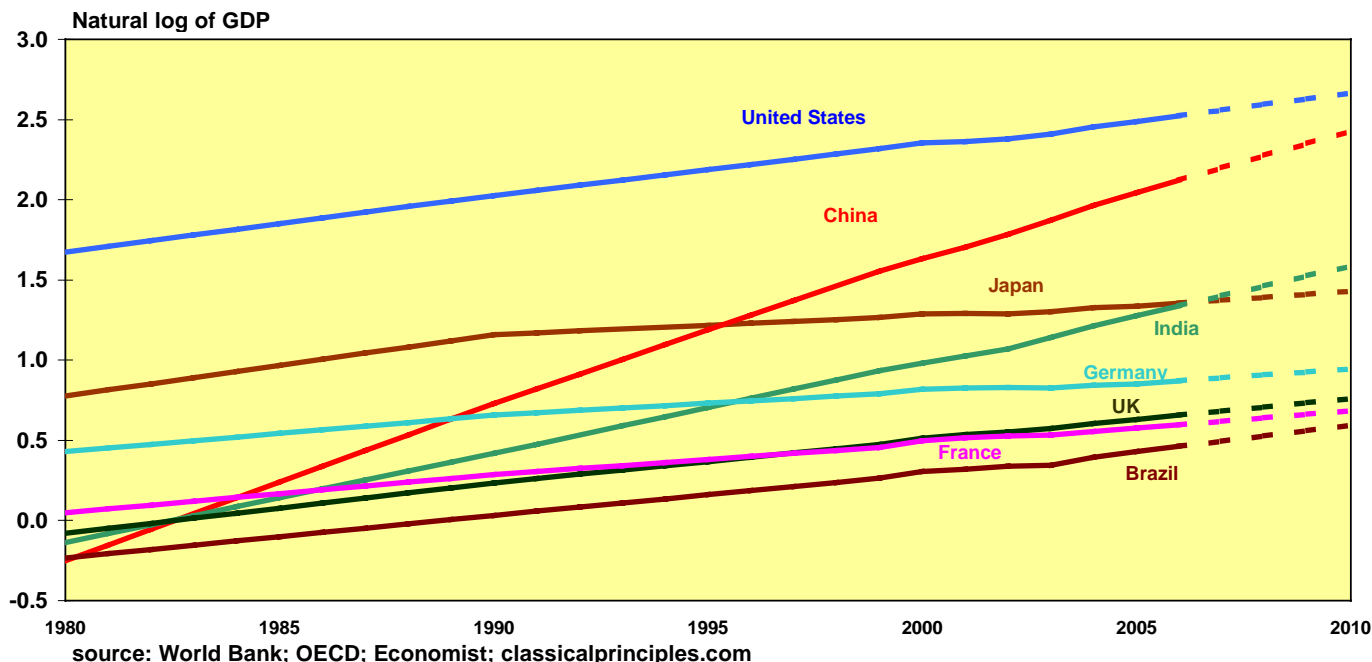


A New World Order: US, China, India are 1-2-3

By Robert Genetski; February 1, 2006

GDP--Major Countries-(Based on Purchasing Power Parity)



The value of goods and services an economy produces determines its economic power. The standard measure of this power is a country's gross domestic product (GDP). When comparing one country's GDP to that of another, it's appropriate to use an exchange rate that attempts to equalize the purchasing power of each country's currency. When this is done, it becomes clear that 25 years ago the three most powerful countries in the world were the US, Japan and Germany.

At that time, Japan's GDP was 40% of the US while Germany's GDP was 30%. During the 1980s, both the US and Japan grew rapidly. Each country was determined to lower tax rates, limit the growth in government spending and promote freer markets. While the US enjoyed rapid growth in the 1980s, Japan's growth was

even more rapid. By 1990, Japan's GDP had risen to 42% of that in the US.

Beginning in 1990, Japan dramatically changed its policies. It replaced the pro-growth policies that made it the second most powerful country in the world and adopted policies similar to those in Western Europe. In 1990 Japan established a value-added tax and raised a capital gains tax. When the economy weakened, it responded by increasing government spending and raising the value added tax.

By following European economic policies, Japan experienced European growth rates. From 1990 to 2005 average annual growth in France was 2% a year, Germany 1.3% and Japan 1.2%. By 2005 Japan's relative position deteriorated to the point that its GDP was down to 32% of US GDP.

Not all countries chose to follow the European model. In the early 1980s, China under the leadership of Deng Xio Ping, chose an alternative set of policies. Chinese leaders studied the writings of the classical economists led by Adam Smith. They concluded that these economists had discovered policies that would produce economic prosperity. These policies emphasized the importance of low tax rates, free markets, limited government spending, protection of property rights and low inflation.

In the early 1980s, Chinese leaders adopted a long-term strategy of gradually implementing classical policies. Today, not only is China the second most powerful economy in the world, but its citizens understand and appreciate the source of its success. A recent global survey indicated that 74% of Chinese respondents agreed that free markets and the free enterprise system was the best system for the future of the world. This was the highest percentage of any country in the world.

In the 1990s, India's government opted to abandon its socialistic policies and pursue classical economic principles. Over the course of the past fifteen years, India's economy has grown at an average annual rate of just under 6%. This year, India's GDP will surpass that of Japan.

Dramatic increases in living standards in China and India provide an important lesson for other countries—economic success depends on the extent to which a country pursues classical economic principles.

While a number of countries are learning these lessons, others are not. In France, only about half its citizens agreed that free markets and free enterprise were the best system for the future. In this regard it's not surprising that the UK recently passed France to become the sixth most powerful economy in the world. In Japan, the government has indicated that as the economy recovers, it plans to increase the value-added tax once again.

One of the few developed economies to retain its relative position in the new world order is the United States. It also happens to be one of the few major developed country to enact a series of major tax cuts over the past ¼ century. In 1978, the US capital gains tax rate was close to 50%. It currently stands at 15%. Tax rates for individuals have also declined dramatically during this period.

With the momentum from changes in economic policy a new world order is emerging. Based on recent policies, the United State, China and India will increase their relative economic power in the decade ahead while France, Germany and Japan will continue to founder.

Economic success or failure is not inherent to any economy. It depends on the policies pursued. The US, China and India have reaped the benefits sound economic policies. By following their lead, other countries can enjoy similar success.