

**Trading Up**  
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**By Michael Schuman / Manzhouli**

For decades, the Chinese town of Manzhouli, perched on the desolate border with Russia, was frozen in a remote corner of the Cold War. As an ideological schism between the two Communist giants escalated into a full-blown conflict — bloody clashes erupted along their 4,300-km border in 1969 — the poor residents of Manzhouli had little contact with their Russian neighbors huddled in the Siberian cold only a few steps away. A mere trickle of state-sponsored trade passed through the heavily fortified border, leaving Manzhouli's citizens dependent on a local coal mine for jobs.

Today, however, Manzhouli is a testament to the wealth that can be created by connecting the world's great emerging economies. As relations thawed between Moscow and Beijing after the 1991 collapse of the Soviet Union, the border opened, private businessmen jumped into importing and exporting, and the fortunes of the two communities merged. Trade between Russia and China reached \$55 billion in 2010, seven times more than in 2000. Timber and oil flow into resource-hungry China, while China's roaring factories ship machinery, textiles and other manufactured goods back in return. About \$9.8 billion of goods passed through tiny Manzhouli in 2010, more than twice the amount just five years earlier. In downtown Manzhouli, Russian tourists troll for cheap Chinese-made boots and winter coats in shopping arcades, where the signs are in Cyrillic and the official haggling language is Russian. With money to be made, Manzhouli became a magnet for northern China's eager and entrepreneurial. The town's population has surged by a factor of 15 since the end of the Cold War, to 300,000. "Before, trade was zero, but now it is booming, and people's quality of life has benefited," says Li Yongsheng, a manager at the Manzhouli Border Economic Cooperation Zone, an industrial park founded by the government to foster business with Russia. "The old hostilities are basically gone." ([See "Global Economy: Was the Past Decade So Bad?"](#))

Manzhouli's success story is being re-created again and again across the emerging world. Flows of goods, people and capital among major developing economies are becoming a larger and larger source of exports, jobs, financing and economic growth for these up-and-coming nations. The trend — a move away from trade and investment flows dominated by Western consumer demand — could reshape the world economy. Tightening economic ties within the emerging world can provide a badly needed boost for a global economy still searching for a route out of the Great Recession — the primary concern of November's Asia-Pacific Economic Cooperation (APEC) summit in Hawaii. The growing linkages are redirecting patterns of investment, trade and migration, altering the role of the U.S. in the global economy, redrawing political alliances and sparking new geopolitical rivalries. And we're just at the very beginning of this history-altering process. Stephen King, chief economist at banking giant HSBC, figures that trade and capital flows between emerging regions of the world — Asia, Africa, the Middle East and Latin America — could increase tenfold over the next 40 years. He calls these new connections "a 21st century version of the original Asian Silk Road" that is "set to revolutionize the global economy."

The signs are apparent everywhere. China, not the U.S., has become India's largest trading partner, with the exchange between the two countries surging 28-fold over the past decade to almost \$62 billion in 2010. When Chinese Premier Wen Jiabao visited New Delhi last

December, the two sides inked \$16 billion in trade and financing deals; when U.S. President Barack Obama journeyed to India a month earlier, he managed only \$10 billion. India and Brazil already export more to fellow emerging markets than to the developed world. China is the largest foreign investor in Brazil, challenging the historical dominance of the U.S. in Latin America, while a \$3.1 billion investment by Chinese oil company CNOOC in Argentine energy firm Bridas was the biggest acquisition in Argentina in 2010. Last year, Russia's Rusal, the world's largest aluminum producer, chose to launch its initial public offering not in London or New York City but on the Hong Kong Stock Exchange, becoming the first Russian firm to do so. ([See photos of Chinese investment in Africa.](#))

### **The New World Trading Order**

The burgeoning trade and investment among emerging countries is a dramatic shift in how the world economy has worked for several centuries. Traditionally, trade has flowed between "North" and "South" — the developed and developing worlds. Natural resources, from spices to cotton, were shipped into the industrialized West, which in return exported textiles and other factory-made goods. After World War II, this system became more complex, thanks to improved transport and communications. Asian upstarts like South Korea and Singapore grew rich off of outsourcing. Their plentiful, cheap labor assembled clothes, shoes and electronics, often with design and technology from the West, then shipped the goods to Walmarts for U.S. consumers. With shoppers in places like India and Indonesia still poor, there was little incentive to reach out to them. Tense relations between developing nations — such as the border conflict between Russia and China that paralyzed Manzhouli — often created more hurdles. The U.S. and Europe dominated the world's trade and capital, and everyone depended on them for growth and jobs.

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That pattern began to change after China jumped into the globalization game in the 1980s. Factories in Shenzhen and Shanghai became the centerpieces of "borderless-manufacturing" networks in which parts for TVs, mobile phones and other goods were produced across Asia, then shipped to China for final assembly, spurring greater trade within the region. As rapid growth in China, India and other emerging markets turbocharged local incomes, they became export destinations in their own right, with fellow emerging-nation companies selling to one another's consumers. The connections continue to draw in more and more parts of the emerging world. Trade between the developing economies of Asia and Latin America, for example, grew sevenfold over the 10 years ending in 2010, to \$268 billion. China and India, seeking access to raw materials and new customers, have become patrons of Africa. Trade between India and Africa has exploded from a mere \$1 billion in 2001 to \$50 billion in 2010. Last year, Indian telecom-service provider Bharti Airtel acquired operations in 15 nations in sub-Saharan Africa for \$10.7 billion in one of the biggest cross-border deals in Indian history. Ganeshan Wignaraja, a specialist in economic integration at the Asian Development Bank (ADB) in Manila, says these emerging-market ties are creating a "third pillar" of growth within the world economy, alongside the U.S. and the E.U. "We're heading toward a multipolar world," he says.

The consequences of that go well beyond the mere movement of goods. The more important trade and investment within the emerging world become, the less important the West becomes to the global economy, a trend accelerated by the Great Recession. While the economies of the West sag under high debt and joblessness, China, India and much of the rest

of the emerging world have powered through the downturn and are looking more and more to one another. And as the major emerging economies grow closer economically, they are discovering shared political interests. The BRICs — Brazil, Russia, India and China — have already started to hold regular summits to coordinate their efforts on major issues like reforming the global financial system. (South Africa joined the latest conference as well.) They are also challenging the established economic order. China and Russia, for example, have led a charge to replace the U.S. dollar as the world's No. 1 reserve currency. If the supersonic trade and investment among emerging economies continues, "the importance of the U.S. and Europe economically and politically would diminish," says HSBC's King. ([Read about corruption and abuse of Power threatening Russia's economic gains.](#))

Corporate executives are discovering new opportunities in their emerging compatriots as well. Companies that might not have broken into developed markets with little-known brand names have found success in emerging markets, where loyalties aren't as fixed. Chinese mobile-phone maker G'Five saw its sales in India surge more than 75% in the past fiscal year; its trendy phones appeal to Indian consumers with thin wallets. Chery, a major Chinese carmaker, would likely struggle in the competitive U.S. market, where Chinese-made goods suffer from a reputation for shoddy quality. Instead, Chery has invested in emerging economies and has 16 factories either operating or under construction in countries such as Russia, Egypt, Iran, Indonesia and Brazil. Chinese PC maker Lenovo decided in 2009 to focus more on emerging economies, believing its experience at home could give it an advantage in other developing nations. In India, for instance, the firm replicated sales techniques that worked in poor areas of China, like showing free movies to villagers as part of PC-marketing road shows. The strategy has paid off. Revenue in emerging markets (excluding Lenovo's Chinese base) ballooned 46.5% in the quarter ending in June, compared with only an 8.5% increase in developed countries, helping the company gain PC market share globally.

### **Building Bridges (Literally)**

The continued integration of the emerging world is far from assured. Developing countries have higher tariffs and stiffer restrictions on capital flow than developed ones. Roads and transport networks have been designed to deliver goods to the U.S. and Europe, not from one developing country to another, often making the shipping of products slow and expensive. As a result, the flow of trade and money is still small compared with that between North and South. Despite its eye-popping growth, trade between India and China amounts to a mere sixth of that between China and the U.S. Persistent political tensions could also flare up and impede economic relations in the future. China and India, for example, still spar over unresolved border disputes, while New Delhi's support for the Dalai Lama irks leaders in Beijing who consider him a dangerous separatist.

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In Manzhouli, there is a gap between the potential of the Russian trade and the reality. The markets at a tourist zone outside town, where Russians can shop without visas for Chinese-made wares, are almost completely shut by 1 p.m. A giant hotel not far from the airport, topped by Russian-style maroon domes, appears abandoned. Chinese officials complain that their Russian counterparts hamper progress by erratically changing regulations and trade policies. "The Russian bureaucrats are not eager to move forward with economic development," says Li of the Manzhouli economic zone. "Chinese officials are willing to

sacrifice their holidays for development. Russian officials never work overtime." There are physical impediments as well. The gauges of the Russian and Chinese railways are different, forcing trade goods to be transferred between trains at the Manzhouli border — a productivity-killing process.

Active efforts are under way to dismantle these barriers. Developing Asian and Latin American countries have completed 13 free-trade agreements since 2004. Russian Prime Minister Vladimir Putin recently raised the idea of forging a free-trade "Eurasian Union" among former Soviet states, and during an October visit by Putin to Beijing, Russia and China formed a joint \$4 billion fund to encourage investment between them. New roads, railways and ports are connecting emerging nations more than ever before. Burma is rebuilding an old road across the country that will link China and India, potentially cutting the cost of transporting goods between them by some 30%. Beijing, wary of relying on the Panama Canal for the shipping of Brazil's vital natural resources, is proposing a new route through Colombia, with a \$7.6 billion railway connecting its Pacific and Caribbean coasts. And China is liberalizing (albeit slowly) its currency regime, encouraging its major partners to use the renminbi instead of the dollar in their trade. HSBC figures that the renminbi could be the currency of choice in at least half of China's trade with other emerging nations in three to five years. ([See photos of China's high-speed rail.](#))

But even as some roadblocks come down, others go up. Competition among major emerging markets for exports, investment, jobs and global influence fuels tensions. Officials in Brazil and India have complained that China's control of the renminbi's value hampers their exports by keeping competing Chinese goods artificially cheap. Resentment toward China spans from Brazil to Zambia over Chinese investors' buying up large swaths of their economies while providing few benefits in return. Resolving such differences could be crucial for the future of the emerging world. As HSBC's King points out, giant emerging economies can no longer count on the overextended U.S. consumer to raise their living standards up to the level of the West; only exports and growth created within the emerging world can achieve that. Consulting firm Accenture estimates that India's expanding business with other emerging markets could create 28.2 million jobs in the country by 2020. And as the emerging world becomes more integrated, pressure mounts on the U.S. and Europe to join in — by, for example, signing more free-trade agreements like the ones Washington approved in October with South Korea, Colombia and Panama. "The story for the developed countries is that you have to get on your bike and be part of the rush to key emerging markets," says ADB's Wignaraja. Otherwise, "you run the risk of being left out."

Huang Jincai has no intention of letting that happen to him. The Manzhouli-based timber processor has pinned all his hopes — and money — on China-Russia trade. In 2003, Huang was a migrant worker, spending long hours in the Russian Far East cutting timber. Today, his desk overlooks a buzzing Manzhouli from the 20th floor of an office tower two blocks away from the new, swank Shangri-La Hotel. Over the past seven years, Huang, his brother and a Russian partner have invested almost \$5 million in a timber-processing factory in Russia that employs 100 people, and this year he started a Manzhouli company to import and sell the timber. Though he regularly confronts difficulties, from bewildering local tax codes to occasional Russian hostility to Chinese workers, those problems can't squelch his enthusiasm. "My life has changed a lot" because of the Russia trade, Huang, 31, says. "I'm pretty optimistic. After all, the trade just can't stop." No, it can't.

— with reporting by Nilanjana Bhowmick / New Delhi, Jessie Jiang / Manzhouli, Simon Shuster / Moscow And Sheena Rossiter / São Paulo

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