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IMPLICATIONS OF THE SHIFT IN GLOBAL ECONOMIC POWER: AN ANALYSIS

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ABSTRACT

As the second decade of the 21st century unfolds and the world exits from the 2008–09 financial crisis, the growing clout of emerging markets is paving the way for a world economy with an increasingly multi-polar character. The distribution of global growth will become more diffuse, with no single country dominating the global economic scene. The coming decades will see global economic growth increasingly being generated in emerging economies. By 2025, global economic growth will predominantly be generated in emerging economies. As a group, emerging economies are likely to experience significant increases in their international trade flows by 2025, in terms of both imports and exports. Although many high-income countries are only gradually recovering from the financial crisis, most developing countries have swiftly returned to their fast pre-crisis growth trend. As the international trade shares of the emerging and developed world converge, global wealth and asset holdings will shift toward emerging economies. This paper not only examines changes in the global economy but also studies the dynamics of international trade associated with the integration of low- and middle-income countries into the global economy.

KEYWORDS

global economic power, financial crisis.

INTRODUCTION

In recent years, the global economy has seen major transition. Not only has there been a global financial crisis, but there has also been a sharp divide in the economic performance of high-income and emerging market nations. The seeds of this transition were planted some time ago. Over the past two decades, the world has witnessed emerging economies rise to become a powerful force in international production, trade, and finance. As the world exits the 2008–09 financial crises, the global economy appears poised to transition to a new set of growth poles, an economy that significantly drives global growth, with some emerging economies prominent among them. Although growth in the advanced economies remains sluggish—a phenomenon that has been described as a “new normal” (El-Erian 2009)—developing economies have recovered from the crisis and are exhibiting robust growth. Global growth in the first quarter of the 21st century thus is likely to be driven by the sustained rise of China, India, and other emerging economic powerhouses.

REVIEW OF LITERATURE

The events since 2007 have brought sweeping changes in the global economy into sharp focus, the rise of low and middle income countries in global trade has been decades in the making. In the international literature, it has been suggested that the various middle-income countries like Brazil, Korea, Mexico, Russia, Argentina, Turkey, Indonesia, Poland, South Africa, Thailand, Egypt, Columbia, Malaysia, the Philippines, and Chile had average annual export growth of 8 percent from 1992 to 2008. According to Amity and Freund (2010) and Harrigan and Deng (2010), held the view that the each of the middle-income countries in 2008, had a GDP above \$ 100 billion; as a group their collective GDP is 1.4 times China and India’s combined total. China’s economic transition, which accelerated in the 1990s. Rodrik and Subramanian 2004 observe that such scenario allowed the country to realize a latent comparative advantage in labour-intensive products. Hsieh and Klenow (2009) argued that India’s surge of growth, which began even before the reforms initiated in 1991, was, like China’s, aided by industries beginning far inside the technology frontier. In the international economics literature, it has been mentioned that we are moving towards a world in which South–South commerce (trade between developing countries is termed as South-South trade) and North-South commerce (trade between developed and developing countries is termed as North-South trade) are overtaking North-North flows (the exchange of goods between the United States, Canada, the nations of Western Europe, and Japan is often referred to as North-North trade). Helpman and Krugman (1985) explained these types of trade using models based on product differentiation and economies of scale. Imbs and Wacziarg (2003), Cadot, Carrere, and Strauss-Kahn (2011) dwell on the idea that the countries exporting different types of goods at different stages of development, with low-income countries producing a narrow range of goods and moving up the product ladder in terms of capital intensity and quality as their incomes rise. Schott (2003, 2004) also holds the same view. Concomitant with recent changes in global trade, Eaton and Kortum (2002) find that the trade theorists have revived the Ricardian model, which for years was used as little more than a tool for introducing undergraduates to international economics.

STATEMENT OF THE PROBLEM

In the recent years, the global economy has seen major transition, one in which economic influence has clearly become very much dispersed. Just as important, developing countries have never been at the forefront of multipolarity in economic affairs. According to the Global Development Horizon (GDH) 2011, World Bank, from 2011 to 2025, the rise of emerging economies will inevitably have major implications for the global economic and geopolitical hierarchy. Increased diffusion of global growth and economic power raises the imperative of collective management as the most viable mechanism for addressing the challenges of a multipolar world economy. Thus, it becomes imperative to study the sweeping changes in the global economy to understand and analyse its implications on the pattern of trade, growth and wealth in the global economy.

OBJECTIVES

1. To study the economic vitality and dynamism of developing economies since 2007.
2. To examine the changes in global economy and study the dynamics of international trade associated with the integration of low and middle income countries into the global economy.
3. To analyse the shift in the pattern of output, growth, trade and wealth in the global economy.

RESEARCH METHODOLOGY

The study is based primarily on the secondary data published by the World Bank and International Monetary Fund. Even, data from earlier research studies have also been used. Research institutions, trade associations, universities and research scholars do collect data but they normally do not publish it. Such unpublished data have also been used wherever relevant.

IMPORTANCE OF THE STUDY

The significance of the study lies in the fact that it not only apprises readers of the sharp divide in the economic performance of high-income and emerging-market nations but also hints the emergence of new poles. This paper is also relevant as it examines changes in the global economy and studies the dynamics of international trade associated with the integration of low- and middle-income countries into the global economy. The paper deals with the shifts in the output

and growth pattern, the flow of international trade and the global wealth towards emerging economies. This paper makes an attempt to understand the changing and evolving position of emerging economies in the global trade.

FINDINGS AND RESULTS

In the years leading up to the global financial crisis of 2008-09, many developing economies were beginning to display their economic vitality and dynamism. Emerging developing world powerhouses such as Brazil, Russia, India and China- the so called BRIC economies (O’Neill 2001) –began to challenge the economic power of the G-7, accounting for an ever-increasing share of global trade, finance, and labour flows. The financial crisis has accelerated this trend.

EMERGENCE OF NEW POLES

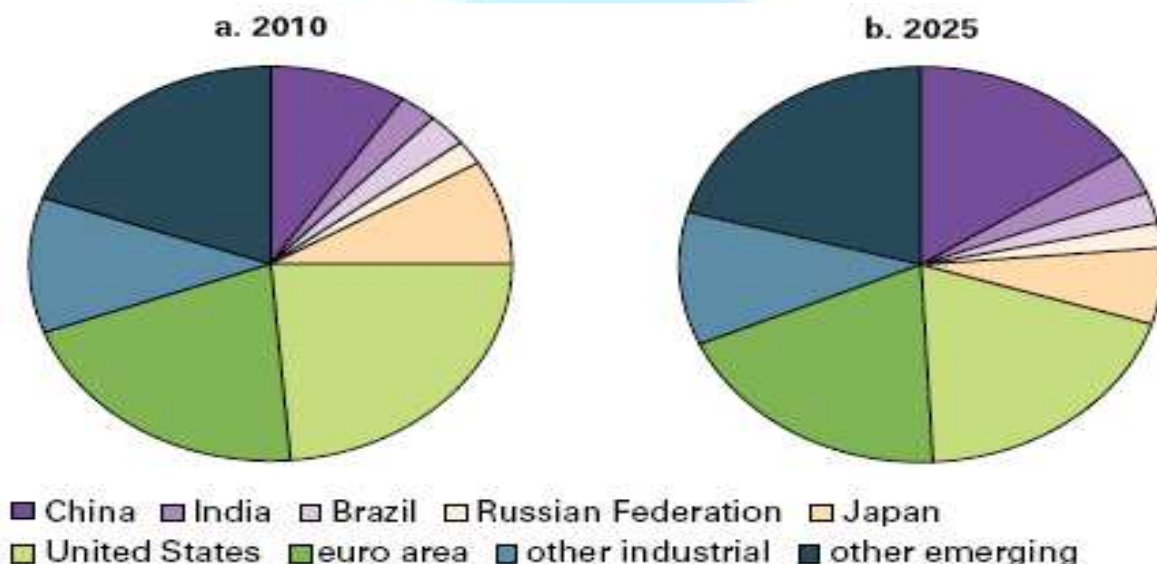
With post crisis economic performance in developing countries undeniably stronger than in developed countries (developing countries as a whole grew by 1.5 percent in 2009, compared to decline of 3.4 percent in developed countries) and near term growth forecasts suggesting developing and emerging economies will continue to expand considerably faster than their high-income counterparts, the global growth poles are beginning to expand beyond developed economies. China and India are likely to be the main flag bearers among emerging market growth poles in the years ahead. This is especially so for China, which overlooked Japan as the world’s second largest economy in 2010 and Germany as the world’s largest exporter in 2009. In the medium term, the proportion of global economic growth represented by other emerging countries such as Brazil, Indonesia, Korea, and Russia likely will increase dramatically. Together with China and India, these countries- epitomized by the BRIC economies but not limited to them-will increasingly become the world’s major consumers, investors, and exporters, affecting both the developed world and the least developed countries (LDCs) with which they interact.

SHIFTS IN OUTPUT AND GROWTH PATTERNS

Under the baseline scenario (Global Development Horizon 2012), emerging economies’ share of global output will expand, in real terms, from 36.2 percent to 44.5 percent between 2010 and 2025 (Chart 1). This impressive rise will be led by China. A simultaneous decline in investment and rise in consumption means that China will average a growth rate of about 7 percent throughout the period even against a backdrop of a rising old-age dependency ratio retaining its strong comparative advantage in manufacturing, with labour productivity in the sector continuing to grow through 2025.

Consistent with the long-term productivity trends, India’s annual growth rates in 2011 and 2025 are 8.7 and 5.4 percent, respectively, with 8-9 percent in the earlier years and lower growth later on. This growth outcome is a consequence of a combination of a gradually rising consumption-in line with India’s growing middle class and a lower reliance on foreign saving – and a corresponding decline in investment (of an estimated 32 to 28 percentage points of GDP). Among the other potential emerging poles, Indonesia and Singapore post strong real output growth performances, averaging 5.9 percent and 5.1 percent in this scenario respectively. Although advanced economies will continue to account for a sizable share of the global economic output in 2025, emerging economies will be the drivers of growth. On average, advanced economies as a whole will grow at 2.3 percent over 2011-25, compared with 4.7 percent for emerging economies (Chart 2).

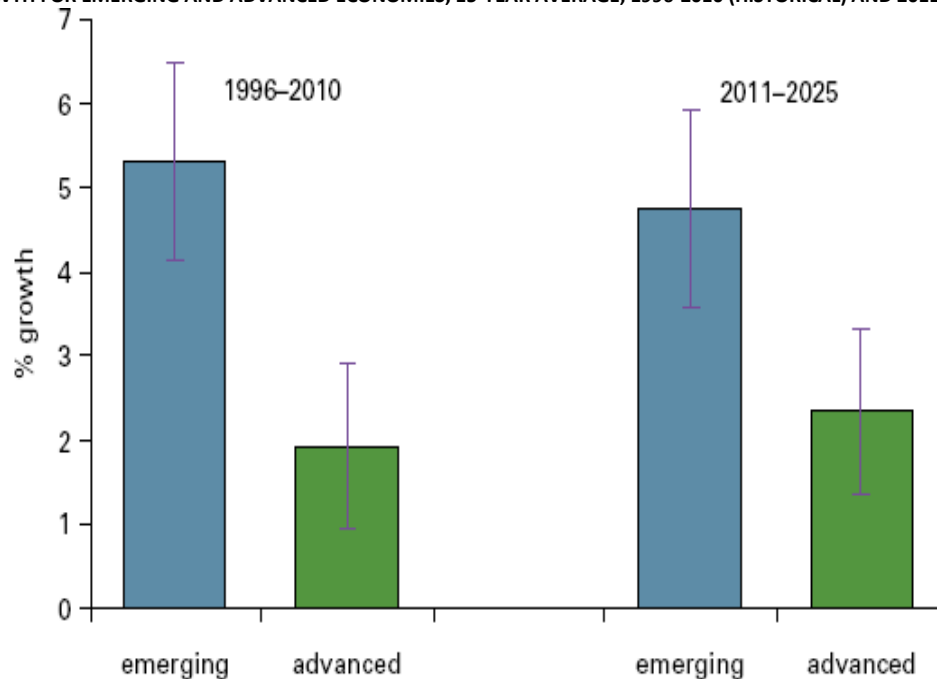
CHART 1: GLOBAL REAL OUTPUT SHARES, 2010 AND 2025



Source: World Bank staff calculations.

Note: Real shares are expressed in terms of constant 2009 U.S. dollar prices.

CHART 2: OUTPUT GROWTH FOR EMERGING AND ADVANCED ECONOMIES, 15-YEAR AVERAGE, 1996-2010 (HISTORICAL) AND 2011-25 (BASELINE SCENARIO)



Source: World Bank staff calculations, from model projections and World Bank WDI database.

Note: Fifteen-year averages reported could significantly understate projected growth rates for any given year, with additional uncertainty from modeling errors. To emphasize the wide range of possible outcomes surrounding the baseline scenario, average growth rates are accompanied by error bars corresponding to the historical 95 percent confidence interval.

SHIFTS IN THE FLOW OF INTERNATIONAL TRADE TOWARDS EMERGING ECONOMIES

Developing countries' share of international trade flows has risen steadily, from 30 percent in 1995 to an estimated 45 percent in 2010. Much of this rise has been due to an expansion of trade not between developed countries and developing countries, but among developing countries. At present, the emerging economies, in real terms, account for 45 percent of global output, compared with about 37 percent in 2011 and 30 percent in 2004. These countries will account for about as great a volume of international trade and investment flows as the developed giants, but also major developing countries such as China and India, which are likely to experience rapid growth in the coming years. The combined real output of six major emerging economies –Brazil, the Russian Federation, India, Indonesia, China and the Republic of Korea (the BRIICKs) will match that of the euro area by 2025. As a group, emerging economies are likely to experience significant increases in their international trade flows by 2025, in terms of both imports and exports. The value of Indonesia's exports, for example, is likely to double between 2010 and 2025, while the value of its imports is expected to be more than one-and-a-half times higher by 2025. Global trade is forecast to expand as a share of global output over the same time period, from 49.9 percent of output to 53.6 percent. Emerging economies will also hold a greater proportion of global wealth as measured by net international investment positions (IIPs).

SHIFTS IN GLOBAL WEALTH TOWARDS EMERGING ECONOMIES

As the international trade shares of the emerging and developed world converge, global wealth and asset holdings will shift toward emerging economies. Emerging and developing countries now hold two-thirds of all official foreign exchange reserves (a reversal in the pattern of the previous decade, when advanced economies held two-thirds of all reserves), and sovereign wealth funds and other pools of capital in developing countries have become key sources of international investment. These current account paths mean that major emerging economies are likely to collectively take on a large and rising net asset international position (albeit at a diminishing rate) in their holdings of investments in developed economies (which, in turn, are expected to build equally large net liability positions). Global wealth and asset holdings will thus shift further toward emerging economies with surpluses, such as China and major oil exporters in the Middle East.

SHIFTS IN THE EXPOSURE OF INVESTORS AND MNCs TOWARDS EMERGING ECONOMIES

As investors and multinational companies increase their exposure to fast-growing emerging economies, international demand for emerging-economy currencies will grow, making way for a global monetary system with more than one dominant currency. The growing strength of emerging economies also affects the policy environment, necessitating more inclusive global economic policy making in the future. Similarly, more than one-third of foreign direct investment in developing countries currently originates in other developing countries. Emerging economies have also increased their financial holdings and wealth. Emerging and developing countries now hold two-thirds of all official foreign exchange reserves (a reversal in the pattern of the previous decade, when advanced economies held two-thirds of all reserves), and sovereign wealth funds and other pools of capital in developing countries have become key sources of international investment. At the same time, the risk of investing in emerging economies has declined dramatically. Borrowers such as Brazil, Chile, and Turkey now pay lower interest rates on their sovereign debts than do several European countries.

CONCLUSION

During the forecast period of Global Development Horizons (GDH) 2011, World Bank, —from 2011 to 2025—the rise of emerging economies will inevitably have major implications for the global economic and geopolitical hierarchy, just as similar transformations have had in the past. The changing role of developing countries will come with major transformations to their economies, corporate sectors, and financial systems. These changes are likely to occur in a wide variety of scenarios. Increased diffusion of global growth and economic power raises the imperative of collective management as the most viable mechanism for addressing the challenges of a changing global economy.

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