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Changing Economic Power in the World Economy

Manmohan Agarwal

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Changing Economic Power in the World Economy

Manmohan Agarwal*

Abstract: The paper finds that economic performance of most regions of the world economy except Asia, both East and South, has suffered since the 1973-74 price rise. China and India have been the fastest growing economies, and have been growing faster than the other emerging economies, Brazil, Mexico, Russia and S. Africa. Continuation of these trends is likely to result in the emerging economies accounting for a much larger share of the world's GDP than they do currently. The largest part of this increase would be because of China's performance with India also contributing a significant portion. The increase in the shares of the other economies would be more limited. While China and would significantly narrow the gap in the size of their GDP with that of the US they would continue to lag substantially behind the US in per capita income. It is therefore essential that these economies continue to grow rapidly even beyond the period of analysis here for per capita incomes of these economies to catch up with that in the US.

Introduction

In this paper we analyse the implications of the rapid growth of China and India for the structure of the world economy and the distribution of economic power among different countries. For this analysis we first discuss the main features of the evolution of the world economy as these might affect future developments. Two features stand out in the development of the world economy in the past years: increasing integration and a major hiatus in the growth of the different economies from 1973-74. The growth behaviour of the different regions is discussed in Section I. In Section II, we analyse the increasing integration of the different economies, including changes in international trade and in capital flows. A major aspect is the increasing

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share of exports and services in GDP as also of private capital flows. In Section III, we discuss the relative importance of the different economies and how they have changed over the past four decades. We then study how their relative importance may change in the future, giving illustrative examples of their projected relative size in 2025 and 2050. In this analysis we look at the increasing importance of some emerging economies, in particular those of India and China. Since the share of an economy in world trade is also an indicator of its importance in the world we also examine how the share of different economies in world trade has changed over the years and what is likely to happen in the future.

I. Macro Economic Performance of the World Economy

a) Deceleration and Increased Volatility of the World Economy: Lagging Growth in Africa and Latin America

The oil price crisis of 1973-74 affected the operation of the world economy not merely in the short run. It profoundly altered the structure of the world economy and its performance over the long run. Till the oil price shocks the world economy had grown rapidly in the post-war period with practically all countries, including the developing countries (LDCs), experiencing faster growth than they had done in any earlier period. But performance in all the regions of the world except Asia, both East Asia and South Asia, suffered after the oil price rises (Table 1). Broadly speaking, growth rates declined, inflation rates worsened and the efficiency of capital, as measured by the incremental output capital ratio, declined.

Of course, various problems had bedevilled the world economy even in the period of rapid growth namely: recovery of the war-ravaged economies; the associated problem of a dollar shortage; concerns about the sufficiency of world reserves including problems with the world gold market and the so-called 'Triffin problem'.[1] The need to accelerate growth in developing countries many of whom become independent in this period was another area of concern. The feeling of many developing countries that not enough was being done to accelerate their growth or remove their poverty apart from the inadequate representation that they had in international organizations. Many of these problems were tackled through innovations in international economic governance.[2] The problem of recovery from war damage, which proved to be beyond the capability of the International Monetary Fund (IMF) and the International Bank for Reconstruction and Development, popularly known as the World Bank (WB), was managed through the establishment of the Marshall Plan. The question of the adequacy of international reserves was sought to be tackled by the institution of Special Drawing Rights and the General Agreement to Borrow. The private gold market was gradually de-linked from the official one to prevent destabilisation because of inadequate gold reserves in the key currency areas, namely the UK and the US. Programmes of technical and financial aid were established, and increasingly more soft aid provided, including the establishment of the International Development Association, the soft-aid affiliate of the WB. The Generalised System of Preferences for LDCs was introduced in order to give them greater access to the markets of the developed countries. This access would, it was believed, both relax the foreign exchange constraint that was hampering growth of the poorer countries and also enable their industries to reach a more viable scale of operation.

Table1: Growth of Per Capita Income[6]

(Annual Average)

Region	1965-73	1974-82	1983-90	1991-2000	2001-05
WORLD	3.3	0.8	1.8	1.2	1.4
OECD	4.3	1.6	3.0	1.7	1.5
LAC	3.5	1.5	-0.2	1.7	0.8
MNA	1.3*	-0.5	1.1	2.1	
SSA	2.3	0.1	-1.1	-0.3	1.3
SA	0.2	2.0	3.5	3.2	4.6
EA	4.5	4.5	6.3	6.0	7.3

* In all the table the data for 1974-82 for MNA is for 1975-82.

Sources: World Bank, *World Development Indicators*, various issues; and World Bank, *World Development Report*, various issues.

Since the 1973-74 oil price rise, there have been very significant changes in the policy framework in all countries. Protection to domestic industry, which had been very high in most developing countries as they tried to develop their industries under protection—the so-called import substituting industrialisation policy, has been drastically reduced.[3] The developed countries had already reduced their levels of protection dramatically by the end of the sixties with the implementation of the

Kennedy Round Agreement.[4] The reforms have extended beyond trade liberalisation as the role of the government in economic activity has declined with the privatisation of many public enterprises. The nature of government intervention has also changed with price incentives very often replacing direct controls, and an increasing use of autonomous regulating bodies to prevent anti-competitive behaviour. Furthermore, the nature of the international financial system has changed with much greater reliance being placed on the market – the major players have given up their attempts to reform and gain control of the system.[5] Aid has declined and private capital markets have become more important.

Economic growth has fluctuated in the OECD countries, with recovery in the 1980s as compared to the seventies and then a worsening in the nineties. Also, performance has varied among the major developed regions. Growth resumed in the US in the nineties, though it remained low in Europe. Europe, which grew in the eighties at the same rate as the US, experienced a growth of less than 2 per cent in the nineties. Japan which had maintained a healthy growth performance even after the oil price rise has performed particularly poorly in the nineties (Table 2). Japan's growth rate has declined from 4 per cent in the eighties to just above 1 per cent in the nineties.

For developing countries, except Asia, conditions continued to worsen in the eighties. East Asia and the Pacific continued to grow very rapidly at about 8 per cent a year, and growth in South Asia increased, as India and Bangladesh in particular, did better. Despite an improvement in the nineties, per capita incomes in Sub Saharan Africa (SSA) continued to decline in the nineties though at a slower rate than earlier. In more recent years, the growth rate has become positive. Despite this upturn, per capita income in the SSA countries has decreased by about 0.2 per cent a year over past more than two decades and has grown by only about .6 per cent a year over these four decades. Growth in per capita income in Latin America in the 1990s recovered to the level achieved in the seventies, though this was still only half the rate in the sixties; but it has again slipped at the beginning of this century.

A consequence of these developments is that the gap between incomes in the OECD countries and incomes in countries in Latin America, Africa

Table 2: Size and Performance of the Economy

	Population (millions)	GDP (B $) 2004	GDP Growth (% per year) 1990-2000	2000-04	GDPPC ($) 2004
World	6365	40282	2.9	2.5	6329
High Income Countries	1004	32245	2.7	2.0	32112
US	294	12168	3.5	2.5	41440
EU	394	11159	2.1	1.3	28321
Japan	128	4734	1.3	0.9	22255
Others	188	4184			
Developing Countries	5361	8050	1502		
East Asia and Pacific	1870	2647	8.5	8.1	2274
China	1296	1938	10.6	9.4	1500
Others	574	709			
South Asia	1447	859	5.6	5.8	594
India	1080	673	6.0	6.2	620
Others	367	186			
Sub-Saharan Africa	726	436	2.5	3.9	601
South Africa	48	165	2.1	3.2	3630
Others	680	269			
Middle East and N. Africa	300	592	3.9	3.8	2730
Latin America and Caribbean	546	863	3.3	1.6	3576
Brazil	184	262	2.9	2.0	3000
Mexico	104	148	3.1	1.5	6790
Others	258	452			
East Europe and Central Asia	472	698			3295
Russia	144	123	-4.7	6.1	3400
Others	328	575			

Sources: World Bank, *World Development Indicators*, various issues; and World Bank, *World Development Report*, various issues.

and the Middle East has increased. Earlier hopes of convergence in levels of per capita income are belied by the experience of the past quarter of a century. Between 1980 and 2005 per capita incomes in most regions of the world declined relative to that in the US. That of Latin America declined from 18 per cent to 10 per cent, of Africa from 6.5 per cent to 1.7 per cent, and even of S. Asia from 2 per cent to 1.6 per cent. Per capita incomes as a percentage of that in the US increased only in East Asia from 3 per cent in 1980 to almost 4 per cent in 2005. The experience of the eighties and the nineties showed that there was no general convergence among the countries.[7] What convergence there was occurred basically among smaller groups of countries, for instance Ireland, Spain and Portugal and a few developing countries in East Asia and South East Asia. But the developing countries in East and South East Asia had much smaller initial per capita incomes; they still have a long way to go before levels of prosperity in these countries approaches that in the developed countries. Average per capita income in the East Asia and Pacific region was only a thirtieth of that in the US, while that of China was only about 2.5 per cent (Table 2).

Even if one looks at the absolute size of the economies, those of developing countries were small. At the end of the century, the US still accounted for almost 30 per cent of the world's income, while the EU accounted for a bit more than a quarter. Japan accounted for 13.5 per cent (Table 2). The other economies were considerably smaller though China accounted for 3.3 per cent of the world GDP and East Asia another 3 per cent. India accounted for 1.5 per cent of world income.

Rates of inflation have been high since the oil price rise (Table 3). Reducing rates of inflation in developing countries has proved difficult unlike inflation in the OECD countries which has declined consistently since the high rates experienced in the mid-seventies. Developing regions, except for Asia, experienced higher rates of inflation in the nineties than in earlier periods. Latin American countries have experienced the highest rates of inflation. South Asia has consistently experienced lower rates of inflation than other developing regions.

Macro stability is supposed to foster economic growth. Yet the fastest growing region, EA, had the highest rate of inflation during 1965-73 and almost the highest during 1974-82. It is only since 1982 that this region has had a better inflation record than most of the other developing regions. The tendency for rates of inflation in East Asia to decline in the eighties and nineties was interrupted by the East Asian crisis of the late nineties. East Asia has grown faster than South Asia despite consistently having a worse record on the inflation front.

Industrial and agricultural growth rates have varied across the regions and over time (Table 4). Agricultural growth rates have usually, except

Table 3: Annual Increase in GDP Deflator

Region	1965-1973	1974-1982	1983-1990	1991-2000
WORLD	5.53	13.85	9.24	43.89
OECD	4.23	12.57	6.77	3.18
LAC	7.39	24.59	26.42	27.27
SSA	4.71	11.72	9.18	16.07
MNA		16.42	14.85	25.48
SA	7.76	9.39	8.29	7.94
EA	22.63	19.72	8.97	12.66

Sources: World Bank, *World Development Indicators*, various issues; and World Bank, *World Development Report*, various issues.

since the 1980s for Latin America, Sub-Saharan Africa and the Middle East and North Africa, lagged behind industrial growth rates. Agricultural growth rates also exhibit greater variability. Industrial growth rates have been particularly high in Asia both in comparison to agricultural growth rates and in comparison to industrial growth rates in other regions. These lagging growth rates have important implications for the balance of payments (BOP) as trade in manufactures has increased much more rapidly than trade in agricultural products.

(b) Investment and Efficiency of Capital

We now try to explain the behaviour of growth rates in terms of investment rates and efficiency in the use of capital. Decline in the growth rates is often ascribed to the structural adjustment programmes implemented as conditionalities to loans from the International Monetary Fund (IMF), is deflationary in the means adopted, namely the tightening of monetary policy and reduction of the fiscal deficit, through strict control of expenditures required under the programme. Furthermore, expenditure control usually falls heavily on capital formation, both physical and human, because it is often difficult to reduce other expenditure items as many of them are already committed expenditures such as servicing of debt, and this lowers the potential growth rate.

This explanation of events seems valid as investment ratios have fallen since the1970s in most of the world, except Asia which has experienced an increasing ratio (Table 5).

Table 4: Sectoral Growth Rates

	1965-73		1974-80		1980-90		1990-2000	
	Agriculture	Industry	Agriculture	Industry	Agriculture	Industry	Agriculture	Industry
World	2.5	4.8	1.8	2.8	2.7	3.3	2.0	2.4
OECD	1.4	3.7	0.5	2.0	2.3	3.2	1.3	1.8
LAC	2.9	6.9	3.7	4.8	2.1	1.2	2.0	3.2
SSA	2.4	13.5	0.3	4.7	2.5	0.9	3.3	1.9
MNA	3.5	8.7	3.1	1.6	5.5	0.6	2.9	4.1
SA	3.4	3.7	2.4	5.4	3.2	6.8	3.1	6.1
EA	3.2	12.7	3.0	9.3	4.4	9.5	3.4	11.0

Sources: World Bank, *World Development Indicators*, various issues; and World Bank, *World Development Report*, various issues.

Table 5: Investment Rates by Region

(% of GDP)

Region	1965-73	1974-82	1983-90	1991-2000	2001-05
WORLD	23.6	23.9	22.5	22.0	21.0
LAC	20.1	22.7	19.2	19.3	20.0
SSA	21.8	24.0	18.5	17.2	19.0
MNA		26.5	23.3	21.7	21.0
SA	14.9	17.8	20.0	21.4	25.0
EA		28.4	28.5	32.6	35.0

Sources: World Bank, *World Development Indicators*, various issues; and World Bank, *World Development Report*, various issues.

In the developing world, except Asia, investment ratios fell sharply in the eighties and nineties. The decline is partly a reflection of the fall in domestic savings rates. The Fund's programmes are often held responsible for the decline in investment as mentioned above. However, when we estimate an accelerator type investment function we find that investment has held up well—it is higher than what the growth in incomes would warrant.

We now discuss the efficiency in the use of capital; efficiency being measured by the incremental output capital ratios. These ratios declined substantially during the past four decades (Table 6). The developing regions, except for Asia, had very similar incremental output capital ratios in the years prior to the oil price rises of 1973-74. These output capital ratios have almost halved. Most of this decline took place after the oil price rise of 1973-74. Many developing country regions experienced further declines in the 1980s. Despite some recovery in the developing world, the output capital ratios are still considerably lower than they were in the period 1965-73. Output capital ratios in the OECD countries recovered slightly in the eighties but declined again in the nineties.

Table 6: Incremental Output Capital Ratios

Region	1965-73	1974-82	1983-90	1991-2000
WORLD	0.22	0.11	0.15	0.12
OECD	0.20	0.09	0.16	0.11
LAC	0.30	0.16	0.09	0.16
SSA	0.27	0.14	0.11	0.13
MNA		0.16	0.10	0.15
SA	0.16	0.22	0.27	0.23
EA	0.32	0.21	0.25	0.21

Sources: World Bank, *World Development Indicators*, various issues; and World Bank, *World Development Report*, various issues.

Analysis also shows that the elasticity of output with respect to capital has remained constant over the decades. Decline in the output-capital ratio can then be attributed to either a slowing down of the rate of technical progress or an increase in the capital labour ratio.[8] It is not clear why the rate of technical change slowed down in the eighties and nineties.[9] Also while an increase in the capital output ratio might be understandable for the OECD countries, it is not clear why this should have occurred in the developing countries, as the reforms were supposed to encourage specialisation in labour intensive goods.[10] The public image is one of massive job displacement in the North because of exports of labour intensive goods and services from the South.

Another surprising aspect is that the ICOR is lower in South Asia than in East Asia. This would tend to support the contention that the higher growth rates in East Asia were due to greater use of factors, particularly higher rates of investment rather than productivity enhancement (Krugman). It also questions analyses that argue that the control and licensing regime in India resulted in efficiencies, particulary the use of more capital-intensive techniques.

II. Increasing Integration of the World Economy

(a) Capital Flows

The international financial system and the nature of capital flows have always been of great importance to developing countries. Foreign capital has served several functions. It has augmented the domestic savings of developing countries enabling them to achieve a higher rate of investment and growth. Foreign capital has also been necessary to finance the balance of payments deficits that have accompanied growth as investment has had to depend on imported capital goods.

Capital controls had persisted in developed countries for the first three decades after the Second World War, even after the European currencies became convertible towards the end of the fifties or in the early sixties. Developed countries did not completely lift capital controls till the late seventies or early eighties. Developing countries, after lagging behind the developed countries in eliminating capital controls, have in recent years liberalised their policies regarding inflow of capital, particularly FDI.[11]

Capital flows among developed countries in the fifties and sixties were mainly of FDI. With larger budget deficits in the seventies and eighties

flows for buying government bonds became important. In recent years, budget deficits have again declined and so capital flows once more are mainly private sector to private sector.

The dependence on foreign capital inflows by developing countries has varied among regions and between time periods. The structure of capital flows has also changed, with the importance of aid decreasing and of private capital flows increasing. The nature of private capital flows has also varied between commercial bank loans, bonds portfolio capital and FDI. In the past many developing countries that had borrowed either from commercial banks or through bonds faced problems in servicing their debt. There is therefore a tendency to shift to non-debt creating forms of capital inflows, and foreign direct investment has become more important compared to other forms of private capital flows.[12] Capital flows to developing countries in the fifties and sixties were mainly aid from official multilateral and bilateral agencies.[13] This changed in the aftermath of the oil price rise in 1973-74 as some of the higher income developing countries borrowed from international commercial banks to finance their BOP deficits. The lower income countries continued to depend on official flows. Most of the eighties were spent in tackling the debt crisis that engulfed many of the countries that had borrowed from banks.[14] Increasingly these countries turned to other sources – mainly bonds and FDI. Some of the dynamic East Asian countries also turned to portfolio capital and FDI to finance their BOP deficits and meet their need for savings to fuel their rapid growth. In the nineties, long-term capital flows, which are less volatile, have grown considerably; short term flows have not only been small but also much more volatile even being negative in some years.

South Asia has consistently run large deficits on the external balance on goods and services larger than those run by other developing regions and these have been financed by capital inflows (Table 7).

South Asia is the only region to run a deficit in the early years of this century. The East Asian region ran surpluses since the eighties after running deficits in earlier years. This is the conventional pattern that a country is expected to follow — running deficits and borrowing when income is low, and running surpluses and exporting capital when income has arisen.[15] The surpluses in Latin America and the SSA regions in the 1980s reflected more their inability to attract enough capital, and the consequent need to run surpluses to repay their external debt or to build up reserves.[16]

Table 7: Current Account (% of GDP)

	1965-73	1974-82	1983-90	1991-2000	2001-05
WORLD	0.2	-0.3	0.4	0.4	1
OECD	0.4	-0.2	0.2	0.6	0
LAC	-0.5	-1.5	3.3	-1.1	3
SSA	-1.1	-1.5	1.2	-1.3	2
MNA		8.7	-5.5	0.6	4
SA	-1.7	-3.8	-4.4	-3.5	-3
EA	-1.9	-1.2	0.4	1.8	0

Sources: World Bank, *World Development Indicators*, various issues; and World Bank, *World Development Report*, various issues.

The changing patterns of capital inflows portend considerable problems for developing countries. Unfortunately, increasingly the capital inflows are considerably larger than the current account deficits and are financing capital outflows, either as foreign investment by residents or debt repayment, and reserve accumulation. In other words, they are not financing higher imports of capital goods needed to sustain a higher level of investment which would raise the growth rate. Since the reserve accumulation is in the currencies of the developed countries, developing countries in essence are lending to the developed countries.[17] Furthermore, the shift to private, particularly FDI, may create problems for many developing countries.

Official capital flows have stagnated while private capital flows have grown. Aid has become insignificant except in the case of SSA (Table 8a). Aid flows as a percentage of GDP were always relatively small in the case of Latin America. There has been a steady decline in the importance of aid in S. Asia. But the relative importance of aid has declined only slightly for Sub-Saharan Africa and has been relatively steady in the case of East. Asia even increasing in recent years.

Gross private capital flows have increased substantially over the years (Table 8b). These flows seemed to have stabilised at about 10 per cent for Latin America and East Asia. They continue to rise sharply in Sub-Saharan

Africa and in South Asia. A continued commodity boom may sustain high levels of private flows in Sub-Saharan Africa, though the flows from privatisation may now decrease. The high rates of growth in South Asia are likely to continue to attract private capital. They would increase even faster if privatisation became more important in India. The relative movements in the importance of aid and private capital flows indicate that the decline in the relative importance is more because of the increase in private flows.

Table 8a : Aid Flows as Percentage of GDP

Region	1965-73	1974-82	1983-1990	1991-2000	2000-05
LAC	0.6	0.3	0.5	0.3	0.3
SSA	2.9	3.1	6.1	5.5	5.4
MNA		2.3	1.3	1.2	1.5
SA	1.8	1.8	1.4	1.2	0.9
EA		0.8	0.7	0.5	0.8

Sources: World Bank, *World Development Indicators*, various issues; and World Bank, *World Development Report*, various issues.

Table 8b: Gross Private Capital Flows (% of GDP)

Country Code	1965-1973	1974-1982	1983-1990	1991-2000
WLD	4.40	6.92	8.85	17.03
OEC	4.36	6.94	9.44	18.18
LAC		7.46	7.75	10.74
SSA		3.43	5.53	10.95
MNA		10.79	7.34	15.56
SA		0.40	1.09	3.55
EA		4.38	4.26	10.85

Sources: World Bank, *World Development Indicators*, various issues; and World Bank, *World Development Report*, various issues.

But it must be stressed that private debt capital is very expensive and few developing countries can afford to borrow significant amounts at that price without running into a debt crisis.

Reliance on FDI is safer, and this has also been increasing. Unfortunately, FDI flows to LDCs have in the past been very concentrated. Analysts looking at absolute amounts received by various countries often draw the conclusion that a few countries receive most of the inflows. For instance, the top 10 developing country recipients account for about 80 per cent of capital flows to developing countries, and China alone accounts for almost a half. The influence of China can be seen in the dramatic rise in FDI as percentage of GDP since the 1990s. But when we measure the inflows in terms of GDP we reach the conclusion that the differences are not so great (Table 9). While FDI usually very significantly influences growth, its effect in some cases may have been limited. FDI inflows may be tied to disinvestment and so might have resulted in only a limited amount of additional investment, though they may still have had beneficial effects because of transfer of technology and management practices. But only countries with the requisite complementary factors can expect to attract significant amounts of FDI. Dependence on FDI as the major form of capital flows to developing countries acts against countries in Africa and Latin America which have an unsettled political system, and there is the potential for civil strife.

Table 9: Gross Foreign Direct Investment (% of GDP)

Region	!965-73	1974-82	1983-90	1991-2000	2001-05
World	1.2	1.2	1.8	3.8	2.2
OECD	1.2	1.3	2.0	4.0	2.0
LAC		1.0	1.0	2.9	2.8
SSA		0.7	0.9	2.4	3.1
MNA		1.5	0.9	1.3	1.0
SA 0	0.1	0.5	0.8		
EA 0.7	1.0	3.5	3.1		

Sources: World Bank, *World Development Indicators*, various issues; and World Bank, *World Development Report*, various issues.

(b) Trade in Goods and Services

A significant feature of the post-war economy has been the continuing lowering of barriers to trade through multilateral trade negotiations (MTNs). In eight rounds of MTNs, the average tariffs on manufactures levied by the developed countries have declined from 40 per cent at the end of the Second World War to about 3.5 per cent after the implementation of the cuts negotiated in the eighth round, or the Uruguay Round (UR). Developing countries, after maintaining high tariff rates till the seventies as these were conducive to policy of import substituting industrialisation, have reduced

tariffs drastically since then. The average tariff in most developing countries is currently about 10 per cent, though African and South Asian countries have somewhat higher tariffs.

The UR also initiated the process of liberalisation of agricultural trade and brought back the textiles trade into the international system. It also started the process of liberalisation of trade in services and sought to extend a clear rule based system into many areas.

As a consequence of trade liberalisation, the export-to-GDP ratio has increased in practically all regions during the past four decades (Table 10). While the increase in the OECD countries occurred mainly in the sixties and seventies, though there has been another spurt in the early years of this century; increase in the developing countries has been more varied. The ratio increased dramatically in the case of East Asia. While in the case of SSA, the ratio which was very high in the period 1965-73 has tended to stagnate. In the case of South Asia most of the increase in the ratio has occurred in the nineties, while the ratio tended to remain relatively constant in LAC for a considerable period before showing a sharp increase in the new century.

Table 10 : Exports of Goods and Services (% of GDP)

Region	*1965-73*	*1974-82*	*1983-90*	*1991-2000*	*2001-2005*
WORLD	14.0	18.8	19.8	21.4	126.0
OECD	12.8	17.4	17.9	18.8	24.0
LAC	9.5	11.5	14.8	14.7	22.0
SSA	23.8	28.1	26.8	28.0	32.0
MNA	42.5	26.8	31.9	35.0	
SA	5.6	7.5	7.9	12.4	17.0
EA 12.4	18.9	23.5	32.8	43.0	

Sources: World Bank, *World Development Indicators*, various issues; and World Bank, *World Development Report*, various issues.

The process of reduction of barriers to trade, which started almost immediately after the Second World War, contributed significantly to the growth of the world economy since the War.[18] However, sceptics point out that the growth rate has declined in the nineties despite further trade liberalisation.[19] The experience of SSA suggests that integrating with the world, i.e. a high trade to GDP ratio, or reducing protection as was done in the eighties and nineties is not sufficient for a higher rate of growth. A successful growth strategy, as has been stressed by many development economists, has to also include supply increasing measures (Arthur Lewis). The structural adjustment programmes of the IMF and the WB included many measures designed to evoke a supply response. But either these were not adequate enough to do so or were not the appropriate measures for evoking a supply response.

A major feature of the exports of developing countries over the past four decades has been the rising share of developing countries in world trade (Table 11a) and the increasing importance of South-South trade particularly in manufactures (Table 11b), though preferential trading arrangements have little role to play in this.

Table 11a : Share of LDC in World Exports (%)

Year	Total Exports	Manufactures
1939	20.1	
1955	24.2	4.7
1975-77	25.3	5.3
1981-83	26.2	11.0
1989-90	25.9	14.5

Sources: World Bank, *World Development Indicators*, various issues; and World Bank, *World Development Report*, various issues.

Table 11b : Share of LDC in Exports of LDCs (%)

Year	Total Exports	Manufactures
1955	24.0	50.8
1970	19.7	33.3
1981-83	27.5	37.2
1989-91	33.2	24.1
1998-2000	37.2	36.2

Sources: World Bank, *World Development Indicators*, various issues; and World Bank, *World Development Report*, various issues.

The increasing importance of South-South trade (Table 11b) has been driven mainly by exports to East Asia, which has been growing very rapidly,

and to Brazil, which is a major partner for Latin American countries. However, the slow growth of Brazil in the nineties has prevented a more rapid growth in South-South trade.[20]

The share of intra-Mercosur exports in the exports of the member countries grew rapidly from 8.9 per cent 1990 to 20.3 per cent in 1995, after which it has stagnated. The share of intra-ASEAN trade has fluctuated between 1970 and 1999, but during the period overall the share has remained constant at about 23 per cent.

Another important feature of trade has been the adverse movement in the terms of trade which has handicapped the export performance of the least developed copuntries, particularly of African countries. Prices of primary commodities have declined almost continuously since almost the middle of the nineteenth century.[21] The experience since the eighties shows that the decline was particularly rapid in the eighties. In the nineties not only has the decline in commodity prices in general been slower, but prices of oil and natural gas have increased. The price of petroleum, after declining from $51.21 a barrel in 1980 to $22.68 in 1990, rose to $27.97 in 2000. The price of natural gas per mmbtu declined in Europe from $4.72 in 1980 to 2.55 in 1990 before increasing to $3.92 in 2000, whereas in the US the price declined from $2.15 in 1990 before increasing to $4.27 in 2000. However, the price of coal per metric ton declined in Australia from $54.72 in 1980 to $39.07 in 1990 and $26.01 in 2000 and in the US from $59.80 in 1980 to $41.67 in 1990 and $32.76 in 2000.

The recent surge in commodity prices and the improved performance of many countries, mostly in Africa and Latin America, reflects the continuing importance of commodity trade despite the considerable diversification that has occurred.

Between 1989 and 1999, the volume of world trade grew at 6.8 per cent a year, exports by LDCs grew at 9.2 per cent a year whereas those by DCs grew by 6.1 per cent a year. Most LDC regions, except Europe and Central Asia and Latin America and the Caribbean, now exported more to other LDCs than they had earlier (Table 12).

The flow of exports reflects purchasing power and demand. About three-quarters of LDC exports go to the DCs corresponding to their share in world income. LDC exports to the developing countries of East Asia and Latin America are 10 per cent and 5 per cent of total LDC exports respectively, whereas the income share of each region is about 6.5 per cent of world income.

Table 12 : Growth of Exports (%p.a.)

Origin Destination	World	DCs	LDCs
LDCs	9.2	9.1	9.4
East Asia & Pacific	11.9	10.9	15.9
Europe & C.Asia	7.9	10.2	4.9
L.A. & Caribbean	10	10.5	8.6
M.E. & N. Africa	3.5	205	506
Sub Saharan Afr.	5.2	3.2	11.8
S. Asia	8.9	8.1	11.8

Source : UN *Year Book of International Trade*, Various Issues

Table 13 a: Regional Shares in Exports of Goods and of Services, 1985 and 2001

	Goods		Services	
	1985	2001	1985	2001
North America	15.4	16.6	19.0	20.5
Western Europe	39.8	41.5	50.8	46.5
Japan	9.1	6.7	5.4	4.4
East Europe*		4.8		3.8
LDCs	25.7	30.5	17.7	24.8
LA	5.6	5.8	4.7	4.0
Africa	4.1	2.4	3.0	2.1
M.East	5.2	4.0	0.7	2.3
Asia#	10.8	18.3	9.3	16.4

Source: WTO (1996, 2002).

* Includes the states of the former Soviet Union.

Excludes Japan, but includes Rep of Korea and Singapore.

In brief, the patterns of growth have changed substantially since the oil price rises of 1973-74. This change in the pattern of growth has adversely affected most of the developing world. However, East Asia has continued to grow rapidly and South Asia has also joined the league of fast growers.

Table 13b: Regional Shares in Exports of Commercial Services and Growth of Exports

	Share in		Average Annual Rate of
	1990	2005	Growth, 1990-2005
Low Income	1.9	3.4	13.1
Middle Income	10.5	16.8	10.1
High Income	87.6	79.8	7.1
EAP	2.9	5.6	12.7
SA	0.9	2.5	15.7
MNA	1.9	1.8	7.6
SSA	1.3	1.2	7.9
LAC	3.3	3.0	7.2

Source: World Bank (2007)

The rapid growth of Asia is seen to presage a shift in the balance of economic power. Many analysts talk in general of the growth of emerging economies and different analysts define these differently, though usually Brazil, China. India, Mexico and Russia are included in this group. Others would add Indonesia or South Africa or Turkey. The slowdown in growth seems to have been largely caused by an increase in the incremental capital output ratio, for reasons that are not entirely clear. The prolonged slowdown in Latin America and Sub-Saharan Africa has finally resulted in a decline in the investment ratio, which would make future acceleration of growth more difficult. This decline has occurred despite the increasing integration of the world economy. Share of exports in GDP have grown, though here South Asia lags behind the other regions. Growth of services trade has grown and at rates faster than that of trade in goods. But few developing countries have a comparative advantage in trade in services, particularly the modern business-related services, and so have not been able to participate in such growth. Here again Asia seems to be better placed. In the last decade or so trade integration has been supplemented by integration of capital markets. The importance of private capital flows, including FDI, has increased. This shift creates problems for many developing countries as they are not able to attract such flows. Also, the volatility of private flows has meant that countries have had to maintain high levels of reserves, which essentially means lending their savings mainly to the US, which reduced the resources available for investment. Developments in trade and financial markets seem to have made it more difficult for developing countries to reach high rates of growth.

III: World Economy in 2025

Short-run forecasts about the relative performance of the different economies are fraught with pitfalls, even though one might expect that recent trends would continue.[22] Today, there is talk of the rising importance of what are called emerging economies, particularly China and India, and that the US would lose its predominant position in the world economy. But it must be remembered that twenty to thirty years ago there was talk of a different triad—Germany, Japan and the US. Fears were expressed that the US would lose its hegemonic role to these economies.[23] Today there is no talk of a threat from Germany or Japan to the leading position of the US. Similarly, one must be cautious in projecting the rise of China and India.

We place the performance of China and India in the context of the emerging economies, specifically what are known as the BRICSAM countries.[24] The BRICSAM countries accounted for about 11 per cent of GDP in 2004, and had a per capita income of $1584, just under 4 per cent of the US per capita income of $41,440. [25] The countries can be divided into two groups, Brazil, Russia, Mexico and S. Africa in one group and China and India in the other. The countries in the first group are considerably richer than those in the second group. The per capita income in Brazil, Russia and S. Africa is over $3000 while that of Mexico is nearly $7000. The per capita income in China and India is just over a $1000. The per capita figures can be expressed in relation to that of the US, the per capita incomes in Brazil, Mexico, Russia and S. Africa are 7 per cent, 16 per cent, 8 per cent, and 8 per cent respectively. Per capita incomes in China and India are 3.6 per cent and 1.5 per cent, respectively of that in the US. But China and India have larger economies as by themselves they account for 7 per cent of world income whereas the first group accounted for only 4 per cent of world income. The two groups also differ in their recent economic performance. The Chinese economy has grown by about 10 per cent a year during the period 1990-2004, and the Indian economy has grown by over 6 per cent a year. In contrast, Brazil, Mexico and S. Africa have grown at an annual rate of about 2.5 per cent, and Russia has stagnated, as its recent growth spurt has not even compensated for the decline in the nineties. The growth rate of China and India has been much higher than that of the world or of developing countries as a whole. That of the others has lagged behind

the performance of the world economy as well as that of other developing countries. While India has done worse than the others in many social indicators such as enrolment in primary and secondary education, infant and maternal mortality rates, malnutrition and the percentage of population in poverty, it has performed much better in terms of income distribution.

Table 14: Countries Ranked by Size of Economy

Countries	2004	1990	1981	1965
U.S.	1	1	1	1
Japan	2	2	2	5
Germany	3	3	3	2
UK	4	6	5	3
China	5	10	8	6
France	6	4	4	4
Italy	7	5	6	7
Spain	8	8	11	11
Canada	9	7	7	8
Mexico	10	14	9	13
India	11	13	13	9
Korea	12	15	21	22
Brazil	13	9	10	15
Australia	14	11	12	10
Netherlands	15	12	14	14
Switzerland	16	17	18	17
Belgium	17	18	17	16
Sweden	18	16	16	12
Turkey	19	22	23	19
Austria	20	19	20	18
Indonesia	21	20	19	21
S.Arabia	22	23	15	23
Norway	23	21	22	20

Sources: World Bank, *World Development Indicators*, various issues; and World Bank, *World Development Report*, various issues.

When we look at the relative size of countries some countries have improved their rank, whereas others have slipped in importance. We ranked the 25 largest countries by their GDP in 2004 (Table 14). We then looked at the relative size of these countries over the previous four decades. We find that, despite differences in economic performance, there has not been any significant change over the four decades in the relative ranking of the top 25 countries by size of GDP in 2004. We find that the Spearman's rank correlation between their rank in 1965 and in 2004 is over .9.[26] This is highly significant as it is more than four times the standard deviation. Few countries changed their rank by more than a couple of positions.[27] What is also interesting is that China was the sixth largest economy in 1965 and only improved to the fifth largest in 2004. India actually slipped in rank from ninth in 1965 to eleventh in 2004. This was due to relatively poor performance between the mid-sixties and the late seventies.[28] The US was the largest economy in 1965, and remained the largest in 2004. A significant change was the rise of Japan from the 5th rank in 1965 to the 2nd by 1981; Korea has also steadily raised its rank from 22nd in 1965 to 12th in 2004.

a) Projections for 2025 and 2050

We considered the increase in per capita for different periods during 1965 to 2004. We then used a rate very close to the growth rate in per capita achieved in the period between 1990 and 2004 for the base projection. For the projection till 2050 we kept the same growth rate for the developed countries as the increase is mainly because of improvements in productivity, and there is no obvious reason for productivity growth to change. For the developing countries we assume a slowdown in growth depending on how close they have reached the US per capita income.[29] Also some adjustment was made to the growth rates for the rapidly growing economies in East Asia and China. For East Asia we assume that the rate of growth of per capita income will decline from the rapid growth experienced in the earlier period to that achieved by Japan in the eighties when it had caught up with the incomes of the richest countries. The major uncertainty in the case of China's economic performance stems from how successfully it will manage to reform the extensive public enterprise sector.[30] China's per capita income is still considerably lower than that of the more advanced economies so we assume that it can continue experiencing a rapid growth in productivity. We assume that the rate of growth in productivity is only one per cent point lower than that achieved in recent years. Also, for India we assume per capita income would grow at about 6 per cent per year till 2025 and somewhat lower subsequently.

The low projections assume growth in per capita income close to the lowest achieved in the period 1965 to 2004, and for the high growth

Table 15 : GDP of the Economies of Countries and Regions

(% age of World GDP)

	2004	2025			2050		
Countries/Regions		Base	Low	High	Base	Low	High
World	100	100	100	100	100	100	100
High Income	80	69	72	66	50	58	42
US	30	28	30	28	22	27	20
EU	28	24	24	22	18	18	13
Japan	12	8	9	8	5	6	4
Others	10	8	9	8	6	7	4
Developing Countries	20	31	28	34	50	42	58
EAP	7	13	13	15	20	21	26
China	5	10	10	11	17	17	21
Others	2	3	3	4	3	4	5
S. Asia	2	5	4	5	12	6	11
India	2	4	3	4	10	5	9
Others	0	1	1	1	2	1	2
SSA	1	1	1	1	2	2	3
S. Africa	0	0	0	0	1	1	1
Others	1	1	1	1	2	2	2
MNA	1	2	2	2	2	2	2
LAC	5	5	5	6	8	6	9
Brazil	1	1	1	2	2	2	3
Mexico	2	2	2	2	3	2	3
Others	2	2	2	2	3	2	2
ECA	4	5	4	5	6	4	7
Russia	1	1	1	1	2	1	2
Others	3	4	3	4	4	3	5

Sources: World Bank, *World Development Indicators*, various issues; and World Bank, *World Development Report*, various issues.

projection we assumed a growth rate close to the highest one achieved during that period.[31] We assumed that economies grew at the base rate for the entire period till 2050 or at the low and high rates till that year.

The share of developed countries in world income drops by slightly more than 10 per cent by 2025, while obviously that of the developing countries increases by that amount (Table 15).[32] The main gainers are in Asia. The improvement in the share of the developing countries is small if the world economy grows slowly; the gain is relatively large if the world economy grows fast. The US remains the largest economy. It continues to account for about 30 per cent of world income. The old EU, 15 member countries, suffers a small decrease in its share of world income. The country which suffers the largest decrease in its share of world GDP is Japan.

Population projections help the US to gain relative to Europe and Japan. Since population is projected to grow by about 0.8 per cent a year in the US while it will decline by about 0.1 per cent a year in Europe and Japan, this difference creates an almost 1 per cent advantage for the US.[33] The difference in population projections is mainly because of migration into the US. The migration also lowers the dependency ratio in the US and enables the US to get skilled workers without having to undergo the expense of training them. China and India experience a large increase in their share of world income.

The share of BRICSAM increases from about 11 per cent of world income to about 20 per cent. This accounts for almost all the increase in the share of developing countries in world income. The share of the first group remains at about 4 per cent. China and India are the countries which experience a large increase in their share of world income to about 14 per cent. China is the main gainer as it doubles its share of world income to about 10 per cent.

The variations in share as these economies grow faster or slower are very limited. The share of the first group increase marginally from 4 per cent of world income to 5 per cent of world income. Per capita income in BRICSAM increases from about 4 per cent of US per capita income to about 6 to 8 percent of per capita income, depending on whether the economies grow more slowly or more rapidly than in the base case (Table 16).

The per capita income in both India and China more than doubles as a percentage of the US per capita income. Per capita income of Russia increases relative to that of the US in the base and high growth cases, whereas for the others they gain relative to the US only in the high growth case.

When we look at the situation in 2050 we see that now there is a substantial decline in the share of the developed countries. Developing

Table 16 : Per Capita GDP of Countries and Regions

(percent of US per capita GDP)

	2004	2025			2050		
		Base	Low	High	Base	Low	High
World	15.3	16	15	16	20	16	21
High Income Countries	77.5	80	78	77	85	79	76
US	100						
EU	68.3	76	69	69	86	69	69
Japan	89.4	81	81	83	81	81	74
Others	54	54	54	49	54	54	43
Developing Countries	3.6	6	5	6	11	7	14
EAP	3.4	8	7	9	17	13	23
China	3.6	9	8	10	21	17	29
Others	0	5	4	6	8	6	12
S. Asia	1.43	2	3	10	4	10	
India	1.5	4	2	4	11	5	11
Others	0	2	1	2	7	3	7
SSA	1.41	1	2	3	3	4	
S. Africa	8.8	10	9	11	22	23	21
Others	0	1	1	1	2	2	3
MNA	4.8	5	5	5	6	5	6
LAC	8.6	9	8	11	18	10	20
Brazil	7.2	8	7	10	17	9	23
Mexico	16.4	18	16	22	33	19	45
Others	0	7	6	7	14	8	11
ECA	8.0	11	7	11	16	9	21
Russia	8.2	14	8	17	25	12	9
Others	0	10	7	10	14	8	18

Note: In 2004 Korea and Singapore in East Asia and Saudi Arabia and Kuwait in the Middle East are in the high income category.

Sources: World Bank, *World Development Indicators*, various issues; and World Bank, *World Development Report*, various issues.

countries account for about 50 per cent of world income. There is also substantial variation in the three cases. In the slow growing case developing countries raise their share to 40 per cent, whereas in the fast growing case they increase their share to almost 60 per cent of world income. Japan's share of world income shrinks to about 5 per cent, which is about half of India's share except in the low growth case and about a fourth of that of China. The share of the US and EU also declines, but the US still remains the largest economy, except in the high growth case when it is slightly smaller than the Chinese economy. But in this case it is unlikely that China will be able to maintain the high rate of growth that has been used. Most developing regions see an increase in their share of world income. But the region gaining the most is Asia, whose share increases to about a third.

The share of BRICSAM increases further to 30 to 40 percent. We now see a much larger difference when growth rates vary. The difference in the share of world income between when the economies grow slowly or more rapidly is more than 10 per cent. But the first group accounts for only 8 to 10 percent of world income. The main increase is in the share of the second group. This would imply that the share of BRICSAM would be larger than that of the US and even approaching that of all the developed countries put together. India and China would together have a share of world income larger than that of the US or the EU. This raises the possibility of a substantial increase in these countries' influence in international economic management. But translating this potential into reality would require coordination and cooperation among these countries. It would be necessary for China to be a part of this group. On the other hand, China and India could by themselves play a substantial role in managing the world economy. Their interest in working together with the others would obviously depend in whether there is a similarity of interest in the manner of operation of the world economy.

But the performance of these countries in terms of per capita income is less impressive. As a share of the US per capita income, the per capita income in BRICSAM increases to between 11 to 21 percent depending on whether the economies grow slowly or rapidly. Therefore if the world economy grows slowly per capita income in BRICSAM would have increased to only about 11 per cent of that in the US at the end of almost 50 years. But if the economies grow rapidly per capita income in BRICSAM would be about 20 per cent of that in the US. Most of the countries in the group would have a per capita incomes of about a third to almost half of the per capita income in the US. India would be the laggard as per capita income in India would be only about 10 per cent of that in the US even after almost half a century of rapid growth. Their lagging per capita incomes points to their need to maintain a high rate of growth, and therefore their common interest in a structure of the world economy most conducive to rapid growth.

A well functioning international economic system, both in terms of trade and capital flows is in their interest.

Though it is unlikely that Japan and Europe would continue to lag behind the US in economic performance there is little evidence as yet that these economies are going to grow at rates that would seriously challenge the US position. The East Asian economies are recovering and are likely to once again experience high rates of growth. But again it is unlikely that they would challenge the US position. The only exception to that seems to be China. With its very rapid growth and large economy it could challenge the US. But we believe that this is not likely to happen in the next two decades. For one, despite its impressive performance its per capita income will continue to be substantively below that of the US. Furthermore, it is now likely to move into more difficult terrain. It will be faced with the more challenging task of reforming its public sector units, including the state owned banking system with its considerable non-performing assets.

b) Development of Trade

The current round of MTNs, the Doha Round, is at an impasse. Prospects for a successful outcome are bleak. Fears are expressed that this impasse might lead to increased protection and an unravelling of the liberal trading regime that has developed since the end of the Second World War. Such an unravelling would adversely affect incomes and growth of the world economy. Fears about increasing protection leading to a reversal of the liberalisation have been expressed on a number of occasions over the past four decades or so.[34] But though protection has increased at times, there has been no large scale turning back on liberalisation. Governments seem to be acutely aware that increased protection is not in their interest.[35]

Today transnationals have a well integrated production structure and will resist any change that disrupts this. Any disruption to this integrated production structure will severely reduce world efficiency and output.[36] Consequently, we do not believe that the integration of markets for goods will be disrupted and, in fact, believe that the tendency will be for them to become even more integrated.[37] While the protection that exists in the developed countries has undoubtedly adversely affected the developing world and we should campaign for its removal, there is no evidence of a rising tide of protection in the developed world. Over the long haul and despite some aberrations, there has been a steady reduction in the levels of protection in the developed countries.

During the past few years, new forces against trade liberalisation have sprung up; but we do not believe that these will successfully roll back integration because such a roll back will have a serious adverse affect on output and welfare. These new forces have different concerns which sometimes, but not always, place them against globalisation. For instance, there is a tendency towards pushing for global acceptance of human rights etc. NGOs championing these causes would obviously like globalisation of these concepts. Conflict arises when economic globalisation is perceived to be against the achievement of these broader goals.

NGOs reflect many people's feeling of a lack of control over their lives and that they have no voice in decisions that affect their lives. The current situation seems in some ways a replay of the 1968 situation. The widespread dissatisfaction and protests at that time had resulted in many believing that the time was ripe for major changes in the organisation of political and social systems, and in particularly in the organisation of the workplace.

Unfortunately, developments since then have moved in a very different direction. Workers' influence has decreased. The extent of unionisation has decreased in practically all developed countries; in many powers of unions have also decreased. Furthermore, there has been a reduction in the security of unemployment; in many countries the real wages of unskilled workers have stagnated if not fallen considerably. At the same time companies are becoming larger and larger through mergers and acquisitions and the pay of chief executives is increasing even when their companies are faring poorly.

The fundamental objective of most of those participating in NGOs is to regain control over their lives. In this sense, it is a question of values; they are willing to sacrifice some economic efficiency for more democratic control.

The problem is to see how to meet their concerns and whether society at large is willing to sacrifice economic well being for greater democracy. This is so particularly as the content of democracy itself is in question. The NGOs themselves have very different objectives. Some would like to use

international means to achieve their ends, i.e. use international sanctions to achieve their human rights or environmental goals.

Others complain of the lack of progress in the fight against poverty, especially in Africa. It is not clear how restricting trade would help the African countries. The problems espoused by the NGOs are genuine; but it is not easy to devise solutions. What new institutions or rules of behaviour of existing institutions may be established to deal with the concerns of NGOs is as yet uncertain.[38] Multilateral and international institutions will be developed both to deepen the process of globalisation as well as to meet the challenge of marrying the economic and non-economic aspects of globalisation. Globlisation will grow as there is greater convergence towards common values and standards.

The other concerns about globalisation stem from the kind of globalisation that should be achieved and its pace. The US is forcing the pace and also pushing a form of globalisation reflecting its own social values and structures. Spread of communications, knowledge of other societies and mobility will lead to development of a sort of international culture. But what this amalgam will be, how fast it will spread and what room there will be for local preferences are the issues at stake, and the outcome is not clear.

Since rolling back economic integration would not in any case solve the concerns agitating NGOs, and since, while the benefits are uncertain, the costs in terms of disruption of output and reduction of welfare are more certain, we do not think that integration will be rolled back.

The importance of services will grow as more and better services will be required to move components and parts efficiently. Furthermore, the process of goods being transformed into services that has been observed in recent years will continue. Trade in services will also grow rapidly.

The growth in trade will mean an increasing role for the WTO. The main issue is the relation between regional and multilateral trading organisations. The US has used the option of regional trade to push its point of view on multilateral liberalisation. With increased multilateral liberalisation, we expect the impetus towards regional trading arrangements will decline. The danger, however, is that the world trading system may break into three trading blocs centref around the US, Europe and Japan. We expect that overall liberalisation will lead to reduced importance of regional trading arrangements.

The major markets, according to the above assumptions, will continue to be in the US, EU and East Asia with the importance of the latter increasing. We ran a simple regression of share of exports in GDP against income and population.[39] The actual and predicted shares of exports in GDP for the largest economies are given below (Table 17).

Table 17 : Share of Exports in GDP, 2005

	Actual	Predicted
US	10	12.7
Japan	13	18.7
UK	26	25.1
Germany	40	23.3
France	26	26.0
Italy	26	27.8
Korea	43	36.0
Mexico	30	34.8
S.Africa	27	43.5
Turkey	27	39.7
Russia	35	34.7
Brazil	17	33.8
Thailand	74	42.1
Iran	39	41.7
Colombia	22	45.4
China	38	29.2
Ukraine	54	45.2
Philippines	47	40.0
Indonesia	34	33.5
Egypt	31	40.9
India	21	27.5
Vietnam	70	37.9
Nigeria	53	34.0
Bangladesh	17	32.7
Ethiopia	16	29.8

Sources: World Bank, *World Development Indicators*, various issues; and World Bank, *World Development Report*, various issues.

The average share of exports in GDP for this group of countries is 33.4 per cent. China's actual share is much higher than the predicted share as also the average for this group of countries. This in contrast to most of the other BRICSAM countries for which the actual share is usually less then the predicted share; for some like Brazil and S. Africa the gap is considerable. We assume that for these BRICSAM countries the gap between actual and predicted shares will disappear by 2050. For the other countries where the gap is small we assume that share of exports in GDP will increase somewhat faster than that of the world as a whole. The main question mark is about China? Will its share go on increasing or at what level will it stabilise? The share of exports to GDP increased between 1990 and 2005 for the world from 19 to 26 percent, whereas for this group of 25 countries it increased from 20 to 34 percent. We therefore assume that the share of trade in GDP will continue to increase, but at a slower pace. It will be 33 per cent by 2025 and 40 per cent by 2050. The corresponding share for the large economies will be 41 and 50 percent, respectively. If we will assume that the share for China will also continue to increase, but at a slower rate, then it will be between 40 and 50 percent of GDP. On these assumptions the shares of the BRICSAM countries in world trade are given in Table 18.

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Table 18 : Share in World Exports (%)

	2005	2025	2050
Brazil	1.2	1.5	1.7
China	7.3	12.7	20.4
India	1.5	3.4	8.5
Mexico	2.0	2.1	3.0
Russia	2.3	1.2	2.0
S. Africa	0.4	2.4	1.1

Sources: World Bank, *World Development Indicators*, various issues; and World Bank, *World Development Report*, various issues.

While the shares of the BRICSAM countries increase, it is again seen that the main increases are in the shares of China and India. Continuation of present trends would make China a formidable player in international trade as it will account for almost 20 percent of world exports. This seems unrealistic as the largest share currently is of the US at 10 per cent. Then is Germany at 9 per cent. Therefore, it is unlikely that China's share in world exports can go on increasing at the rapid rate it has in recent years. But even if the share stabilises at 10to 12 per cent of world trade China would be a formidable player.

IV. Conclusions

The paper finds that economic performance of most regions of the world economy except Asia, both East and South, has suffered since the 1973-74 price rise. China and India have been the fastest growing economies, and have been growing faster than the other emerging economies, Brazil, Mexico, Russia and S. Africa. Continuation of these trends is likely to result in the emerging economies accounting for a much larger share of the world's GDP than they do currently. The largest part of this increase would be because of China's performance with India also contributing a significant portion. The increase in the shares of the other economies would be more limited. While China and would significantly narrow the gap in the size of their GDP with that of the US they would continue to lag substantially behind the US in per capita income. It is therefore essential that these economies continue to grow rapidly even beyond the period of analysis here for per capita incomes of these economies to catc up with that in the US.

Economic power is often manifested through a country's market size and share of world trade. Since usually over an extended period a country's exports and imports should balance, we analyse these countries share of world trade. China's share has been rising very fast and continuation of these trends would suggest that in about forty years China would supply about 25 percent of world exports, which we think is unlikely as the largest share currently is about ten percent, that of the US. So the challenge for Chinese policy makers is to shift the engine of growth from the external market to the domestic one. Other emerging economies can continue to depend on the world market for their dynamism. But all emerging markets have been increasing their interaction with the world economy and a smoothly operating world economy is in their interest.

Endnotes

[1] The Triffin problem referred to the need for the supply of international reserves to increase as trade grew. But world production of gold was inadequate to meet the requirements of world reserves. The gap would have to be met by expansion of holdings of key currencies, particularly the dollar, in the reserves of other countries. But dollar holdings would increase only if the US ran a balance of

payments deficit. But if the holdings of dollars increased too much as compared to US gold holdings, confidence in the dollar would be eroded resulting in countries converting their dollar holdings into gold further diminishing the US holding of gold. Thus according to Triffin the world economy was caught in the dilemma where either inadequate holdings of reserves forced countries to adopt restrictive import policies or a loss of confidence in the dollar (Triffin, 1960). For a discussion of how important this phenomenon was see De Grauwe, 1996..

[2] These concerns were partly responsible for the establishment of the UNCTAD and also the demand in the seventies for a New International Economic Order. For an analysis of the debate about the NIEO, see Bhawati and Ruggie, 1984.

[3] Much of this reduction was undertaken either unilaterally or in response to conditions imposed by the IMF or the WB for access to their loans. Developing countries participated strongly in the UR. But most of their liberalisation in the UR agreements was in terms of binding their tariffs. The tariffs were usually bound at rates substantially higher than the actual rates being levied by most countries.

[4] Further reductions occurred because of the Tokyo round and Uruguay Round agreements.

[5] The failure of international monetary reform in the seventies is discussed in Williamson, 1977. Also subsequent to the various crises that affected the world monetary system in the 1990s there was considerable talk of developing a new financial architecture. But little emerged in concrete terms.

[6] The categories are the same as used by the World Bank. LAC stands for Latin America and the Caribbean, MNA for the Middle East and North Africa, SSA for Sub-Saharan Africa, SA for South Asia and EA for East Asia and the Pacific. The sources of data for the tables, except where explicitly noted are various issues of the World Development Indicators and the World Development Report, both published by the World Bank, Washington D.C.

[7] For a discussion of convergence see Barro and Sala-I-Martin, 1992.

[8] Since the elasticity of output with respect to capital is constant we can assume a Cobb-Douglas production function. The $^{n}Y/K = A(L/K)^{\alpha}$ where á is the elasticity of output with respect to capital, Y is output, K capital, L labour and A technology. So Y/K is the output capital ratio. A lower Y/K implies a lower A, state of technology or a lower L/K, namely a higher K/L or capital labour ratio.

[9] There was evidence that the rate of productivity improvement had decreased in the US after the oil price increases. But subsequently the rate of productivity growth recovered to the earlier rate. Many would argue that innovation that saved on time, such as just in time production methods, should have resulted in a reduction in the capital output ratio number if capital is measured in an Austrian sense. Prof. Mrinal Datta Choudhary particularly stressed this point in discussions.

[10] It had been argued that overvalued exchange rates, labour market imperfections and direct controls had all encouraged the adoption of capital intensive techniques. A high capital output ratio in economies with protective trade systems was used as an indicator of the inefficiency of the policy regime (Bhagwati, Bhagwati and Srinivasan, 1975).

[11] Many developing countries, those with established stock exchanges, have also liberalised their rules regarding portfolio investment. Many others have taken steps to establish stock exchanges.

[12] Portfolio flows have usually been limited because of the lack of substantial capital markets in most developing countries. However, in recent years a number of countries have established stock exchanges and have taken steps to improve the functioning of capital markets so portfolio flows may become more important in the future. However, developing countries remain chary of such financial flows as they fear these may be unstable creating problems of macro management.

[13] The need for aid to accelerate growth has always been an important component of development policy analysis. In the 1960s, models were developed to try to estimate the amount of aid needed by a country in order to achieve its growth target (Chenery and Stout, 1966; Chenery and Bruno, 1962).

[14] South Korea which was an important borrower from commercial banks was one of the exceptional countries that escaped a debt crisis.

[15] It must be remembered, however, that the surpluses in E. Asia particularly in recent years are mainly because of the huge surpluses achieved by China, a relatively poor country.

[16] The current account balance of MNA is heavily dependent on the price of oil. When this price is high the countries run surpluses and deficits when it is low.

[17] Of course, much of this is financing the large current account deficits run by the US.

[18] There is a general belief among economists that trade liberalisation has been responsible for the rapid economic growth in the post war period.

[19] The sceptical viewpoint is argued by Taylor, 1991; Rodrik, 1995; and Rodriguez and Rodrik, 2000.

[20] For a discussion of the problems of South-South trade, see Agarwal, 1991. For more recent forces pushing the South towards regional trading arrangements see Bhagwati, 1996; and Bhagwati and Panagariya, 1996.

[21] Analysis of commodity prices has confirmed Perbisch's hypothesis. Commodity prices declined by about .6 per cent a year between 1870 and 1939 (Spraos, 1983), and at about the rate between 1900 and 1980 (Grilli and Wang, 1988). Commodity prices declined particularly rapidly in the 1980s, and at a somewhat slower speed in the 1990s.

[22] The seventies and eighties saw many analysts talk about the decline of US power and hegemony. Many economists and business management experts extolled the superiority of the Japanese and German model of capitalism based on certain corporate features as compared to the US and UK system which was more individualistic and more market based. Prof. Thurow, Dean of the Solan School of Management at MIT, and Prof. Laura Tyson, who headed President, Clinton's Council of Economic Advisors were two well-known exponents of this view.

[23] In the 90s analysts talked about a tripolar world – the US, the LEU and Japan. Today, analysts talk of a different tripolar world – the US, China and India.

[24] We define these as Brazil, Russia, India, China, South Africa and Mexico. We do not consider ASEAN in this grouping as ASEAN is not yet a country nor has it shown homogeneity in policy making.

[25] For a number of reasons we make the comparisons at official exchange rates and not at purchasing power rates. Particularly as we are interested in comparing these countries over a period of almost 50 years over which some of them will

be catching up substantially with the US. In these circumstances, it is not appropriate to take the PPP exchange rate as fixed because as is well known the gap between the official and PPP exchange rates narrows as the per capita income gap narrows.

[26] We had to exclude Russia from the comparison as we could not get data on its GDP for the earlier year. Also there were a number of small European countries who were in the top 25 for four decades, but have now dropped out. We took the top 25 countries in 2004 and then ranked them in the previous years dropping countries which were not in the top 25 in 2004 from the comparison.

[27] The only exception is Korea.

[28] This poor performance was partly because of exogenous shocks as the poor harvests in 1965- 67, the oil price increases in 1973-4, the cost of feeding the refugees who came over from Bangladesh then east Pakistan and the later war with Pakistan, and the adjustment to cut-off of aid from the US and the World Bank in the mid-sixties. The cut-off of US aid persisted whereas that of the World Bank was later reversed.

[29] The growth experience of many countries shows that it is difficult to make the transition from a growth path based on growth in the use of factors to that based on increases in productivity.

[30] Concerns are also expressed that the demand for democracy may rise with increasing incomes. The transition could be traumatic and interrupt growth of the economy. We are not so pessimistic as many countries have handled the transition from an authoritarian regime to a democratic one quite successfully. Furthermore, the Chinese policy makers have shown a remarkable capacity to change policies over time without disrupting growth.

[31] We assumed that all countries or regions experience faster or slower growth. This implicitly assumes that the variations are due to global factors and not to internal policy actions.

[32] Our results are different from those of some other analysts. We have not used purchasing power parity (PPP) GDP for the projections. Apart from other problems with using PPP figures, a major problem is that the exchange arte in PPP calculations is higher and the gap is greater the larger the differential between incomes. If, incomes in China and India approach those in the developed countries then consistency requires that the PPP exchange be allowed to approach the official exchange rate. Continuing to use the PPP exchange rate is thus inconsistent and leads to the strong results of some other analysts. Since we do not know how exchange rates will change as incomes in developing countries approach those in the US we have preferred to project incomes in official exchange rates.

[33] Population structure has also been changing and is expected to change further with 'the graying of the population'. Fears are expressed of the resulting strain on the social security system and on savings rates. With a longer post retirement period, people will save some more during their working age and so net effect on savings rates would be limited. Also one should expect changes in retirement patterns and dependency rates. We do not expect the change in population structure to affect significantly the relative sizes of the economies.

[34] Trade liberalisation has sometimes been compared to a bicycle which must roll on if it is not to fail. Trade analysts would like Cassandras always predicting an increase in protection and disaster looming under a new round of negotiations is begun.

[35] Increased protection by one country is likely to lead to increased protection by others and we might be back to the situation in the 1930s when protection increased substantially which contributed to a decline in trade and increased unemployment. Governments are very aware of this and do not seem, therefore to want to increase protection.

[36] An analogy can be provided by the break-up of the Soviet Union that disrupted the integrated economic system that had prevailed; this disruption contributed to the large decrease in output and incomes in the successor republics.

[37] The process of integration that has been occurring can be looked at from many different viewpoints, including some dissent as to whether there has been a substantial increase in integration. Some of the references in the bibliography reflect the different viewpoints.

[38] See Keohane and Nye, 2000, for a discussion of this issue.

[39] This specification has been used by Chenery and Syrquin, 1975, and Chenery and Taylor, 1968.

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