

Understanding Emerging Economies

Deciphering Growth

Prof. Poonam Kumar, Chairperson, Mega Ace Consultancy was invited to the Durham Business School, Durham, UK to deliver a Special Lecture on Emerging Economies. Following are the excerpts from her Lecture.

The topic of my lecture is Emerging Economies. The aim is to understand and get a feel about the emerging economies. How these economies have made their transition towards economic growth, their characteristics and comparative evaluation are also some of the interesting topics of discussion. It is imperative to understand the importance of emerging economies and what have been their business strategies.

Emerging economies are low-income, rapid-growth countries using economic liberalization as their primary engine of growth. These economies can be divided into two groups: developing countries in Asia, Latin America, Africa, and the Middle East and transition economies in the former Soviet Union and China.

There has been more than one definition of emerging economies. Some of the emerging nations can be termed as re-emerging nations since they are in a process of regaining their earlier eminence. Countries like China and India were world's two biggest economies till 19th century. With the industrialization in UK, these countries lost their leadership position in global trade. But, today's globalized world has provided them a golden chance to regain their glory. Therefore, they are reemerging and trying to regain the lost share.

Emerging economies were earlier low-income nations. The transition towards emerging economies from low-income contains some unique features. Firstly, countries have been leveraging past with enhanced two-way trade and capital flows. Secondly, countries have moved from socio-economic backwardness to leveraging market potential. Another major characteristic is the movement from dependence to human resource capacity building. These countries have opted for market-orientation in lieu of state-led development. The profile has also changed from development assistance to investments.

Emerging economies have some unique features which help identify them. Some of them are (a) Market-Oriented Economic Restructuring; (b) Offer new opportunities for trade, technology transfers, and foreign direct investment; (c) Presence of a large Human Resource base; (d) Immense impact on global economics and politics.; (e) Important and large individual markets; (f) Politically stable and robust legal and financial environment; (g) Less dependant on foreign capital.

These emerging economies have a far greater influence on the performance of the rich economies than is generally realized. Emerging economies are driving global growth and having a bigger impact on developed countries' inflation, interest rates, wages and profits. Emerging economies as a group have been growing faster than developed economies for several decades. But, the difference is clear now between these two types of economies. The first reason is that the gap in growth rates between the old and the new world has widened But more

important, emerging economies have become more integrated into the global system of production, with trade and capital flows accelerating relative to GDP in the past ten years. Information Technology [IT] has played an important role in the emergence of these economies. IT has helped in reorganizing production across borders. With the help of IT, once non-tradable services, such as accounting, are being provided from afar, exposing more sectors in the developed world to competition from India and elsewhere.

The importance of emerging nations can be gauged from the fact that in year 2005, emerging economies accounted for more than 45% of global GDP on PPP basis. Developed economies are no longer the dominant player in today's global world. The influence of developing and emerging nations on developed nations is much greater. These countries over the years have been increasing their share of global GDP in an impressive way. The rates of growth of GDP in these countries have also been phenomenal with the help of multilateral trade and availability of low-cost skilled manpower. Emerging economies have registered higher GDP growth rate and outperformed their counterpart developed economies. By year 2040, Chinese GDP is forecast to surpass US GDP. Similarly, by 2040 India can expect to surpass Japanese economy.


Emerging economies accounted for more than 80% of global population and more than 60% of foreign exchange in 2005. Energy consumed by these nations was more than 45% of global energy consumption for a 40% of total global exports. In terms of stock market capitalization, emerging economies had a share of more than 10% of global stock market capitalization. These economies have accounted for more than four-fifth of growth in oil-demand in last five years.

Brazil, Russia, India and China are the four biggest emerging economies, grouped together under the acronym BRICs, account for two-fifths of the total GDP of all emerging economies. China and India are generally seen as the two giants among them. This is true in purchasing- power-parity terms, but in current dollars Brazil and Russia both produce more than India. At market exchange rates, only China and Brazil rank among the world's top ten economies, but in purchasing- power terms all four BRICs make it. Goldman's economists predict that if governments stick to policies that support growth, by 2040 China will be the world's biggest economy at market exchange rates. By then there will be five emerging economies in the top ten: the four BRICs plus Mexico. Together, they will be bigger in dollar terms than the G7 economies.

Because of many attractive features, emerging economies have been witnessing lot of activities and investment. Companies from developed nations are either outsourcing their operations or making emerging economies their second best base for their global operations. Emerging

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economies such as India, China, Malaysia, Philippines have become favorite destination for investment and return. In many of cases, a substantial amount of revenue for MNCs is generated from countries like India.

In the past five years, annual growth in emerging economies has averaged at almost 7%, fastest in recorded history compared to 2-3% in rich economies. According to International Monetary Fund [IMF], emerging economies are expected to grow at 6.8% a year in coming 4 years. If this rate of growth is continued for coming 20 years, emerging economies can account for two-third of global output [in terms of PPP].

Since 2000, global GDP per head has grown by an average of 3.2% per year which is more than 2.9% annual growth during the golden age of 1950-73. The contribution of emerging economies has been substantial in this growth. Among all the emerging economies, China is the biggest nation and therefore has impacted global system in a big way. The openness of China has attracted almost all the big MNCs from developed countries. The sum of China's total exports and imports amounts to around 70% of its GDP, against only 25-30% in India or America. By next year, China is likely to account for 10% of world trade, up from 4% in 2000.

The increased growth visible in emerging economies has attracted much criticism because of job losses in developed countries. But, it should be seen in positive context. The future growth will come from developing and emerging nations mostly. The sustaining growth in emerging economies has potential to provide stimulus for the global growth. There has been visible increase in potential output of world economy with the increased productivity gain by emerging economies. Many developed nations have been feeling social backlash for outsourcing jobs to emerging economies. This has made them follow protectionism measures.

But, rather than blocking change, governments need to ease the pain it inflicts in various ways such as with a temporary social safety-net for those who lose their jobs; better education to equip workers for tomorrow's jobs; and more flexible labor markets to encourage the creation of new jobs. Governments may need to redistribute the benefits of globalization more fairly through the tax and benefits system according to some studies, countries with more generous social welfare policies are less likely to support protectionism.

This increased vitality in emerging economies is raising global growth, not substituting for output elsewhere. The new found enhanced purchasing power in emerging economies boosts real incomes in the rich world by supplying cheaper goods, such as microwave ovens and computers, by allowing multinational firms to reap bigger economies of scale, and by spurring productivity growth through increased competition. Thus emerging economies help to lift growth in world GDP just when the rich world's greying populations would otherwise cause it to slow. Developed countries will do better from being part of this fast-growing world than from trying to cling on to a bigger share of a slow-growing one. Off shoring, like trade, is beneficial to developed economies as a whole. Rising exports give developing countries more money to spend on imports from richer ones. And although their average incomes are still low, their middle classes are expanding

fast, creating a vast new market. This provides a great opportunity for the developed countries for imports.

The developed economies as a whole will still benefit hugely from trade with emerging economies. Increased competition and greater economies of scale will boost the growth in productivity and output. Consumers will enjoy lower prices and a greater variety of products, and shareholders will enjoy higher returns on capital. Although workers will continue to see their pay squeezed, they can still gain as consumers or as shareholders, either directly or through their pensions. A study by the Institute for International Economics estimates that globalization is benefiting America's economy by \$1 trillion a year, equivalent to \$9,000 a year for every family.

With such attractiveness, emerging economies are prone to many risks also from banking crises to unrest in response to widening income inequality. Some could be badly hurt by a slump in demand in America or China and a consequent fall in commodity prices. Emerging economies tend to be subject to economic ups and downs just similar to America during its take-off in the late 19th century. But these risks seem to be manageable keeping in mind economic policies of emerging economies. They need to take advantage of the present period of strong growth to push ahead with reforms.

Although emerging nations are attractive destinations for investment, they face some challenges such as (a) Need for Sustainable Development; (b) Challenge to Build risk management capabilities; (c) Lack of Political Stability; (d) Socio-Economic Underdevelopment; (e) Infrastructural Bottlenecks; (f) Capacity Development; (g) Civil Society and Governance.

But these challenges are not insurmountable. With the help of good planning and strategies, emerging economies can overcome the challenges and be a successful model to emulate. The strategies can be (a) Globalise Research and Development (R&D); (b) Partner in Capacity Building; (c) Develop unique value propositions; (d) Develop unique management strategies; (e) Evaluate and understand the socio-cultural aspects; (f) Harness global value chains; (g) Build risk management capabilities.

For globalization to benefit economies, resources must be reallocated towards higher-value-added goods and services. So to reap the full gains, Europe must urgently push ahead with making its markets more flexible and open. A study by the European Commission concludes that, if the European Union were fully to embrace the rise of China and India, its GDP per person by 2050 could be up to 8% higher than it would otherwise have been, implying a boost to average annual growth of 0.2% over the period. If, on the other hand, EU countries lurch towards more protectionist policies, GDP per head could be 5% lower than in the base case.

The fact that people in rich countries are fretting about the emerging economies' success, rather than just their poverty, is itself a remarkable tribute to the progress those economies have made. Poverty in the third world is still rife, but rising incomes there should be welcomed by all. As long as they continue on their path of reform, there is an excellent chance that their rapid expansion can be sustained for several more decades.

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